IRS Tax Reporting
Changes for Investors
IRS Tax Reporting Changes Affecting Investors

As a result of legislation passed by Congress, E*TRADE and other brokerage firms are required to track and report information about the cost of the securities sold to you to the IRS on Form 1099-B. This reporting began with the 2011 tax year and includes the adjusted cost basis for covered securities sold in your taxable brokerage accounts, as well as gross proceeds and whether the gain or loss is long term or short term.

New this year, E*TRADE will be providing cost basis for all non-covered securities on the supplemental information portion of your 1099. This information is for your information only and will not be reported to the IRS. E*TRADE will continue to report gross proceeds on all transactions.

Adjusted Cost Basis
Cost basis is the total cost of an acquired security. When you sell a security, you need to know your cost basis to determine whether you have a taxable capital gain or loss. Cost basis is typically the original purchase price paid for the security multiplied by the share quantity, and includes the adjustments for cost of brokerage commissions and other fees. Cost basis can be adjusted over time due to certain events including wash sales and corporate actions such as stock splits and dividends. Cost basis may also be adjusted if the security is acquired as a gift or from an inheritance.

Covered vs. Non-Covered Securities
"Covered" and "non-covered" are terms defined in the IRS Cost Basis Reporting Regulations. Financial firms are required to report on official IRS tax documents the cost basis of covered securities bought and sold (see "The Phase-In Schedule" below). E*TRADE is not required to report cost basis for non-covered securities; however, for the first time, we are providing this data on the detailed summary section of your 2014 1099-B. This will assist you with your obligation to report cost basis for all securities bought and sold on your Schedule D and/or Form 8949.

The Phase-In Schedule
Different security classes will become covered in accordance with the following phase-in schedule:

<table>
<thead>
<tr>
<th>Security Classes</th>
<th>Are Covered Securities If:</th>
<th>Are Non-Covered Securities If:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks (including domestic and foreign stocks, REITs, ADRs, and ETFs that are not in a Regulated Investment Company (&quot;RIC&quot;) nor connected with a Dividend Reinvestment Plan)</td>
<td>Acquired on or after January 1, 2011</td>
<td>Acquired prior to January 1, 2011</td>
</tr>
<tr>
<td>Stocks in RICs (including Mutual Funds and ETFs) and stocks acquired in connection with a Dividend Reinvestment Plan</td>
<td>Acquired on or after January 1, 2012</td>
<td>Acquired prior to January 1, 2012</td>
</tr>
<tr>
<td>Options, derivatives, debt instruments, and other specified securities</td>
<td>Acquired on or after January 1, 2014</td>
<td>Acquired prior to January 1, 2014</td>
</tr>
<tr>
<td>Complex debt instruments and options included as part of a unit</td>
<td>Acquired on or after January 1, 2016</td>
<td>Acquired prior to January 1, 2016</td>
</tr>
</tbody>
</table>

A security cannot mature into covered status by being held through the applicable date for that security. For example, an equity purchased in 2010 and held into 2011 will not become covered.

The Emergency Economic Stabilization Act of 2008 (EESA)\(^1\) specifies what, when and how brokerage firms must meet the tax reporting regulations. The legislation sets the legal framework for cost basis reporting to occur and was designed to increase the tax filing accuracy of investors.

\(^1\)Sec 403 – Cost Basis Reporting HR 1424/CBR Final Reg 2010 – TD 950
**1099-B**

For tax year 2014, Form 1099-B includes the following information:

- The cost basis of security lots that were sold, adjusted for wash sales and corporate actions
- An indication of whether any gain or loss on a covered or non-covered security is long term or short term
- The amount of any disallowed losses as a result of wash sales (see Wash Sales below)

To facilitate completing Form 8949 and/or Schedule D, your Form 1099-B from E*TRADE presents information in an order similar to the 8949/Schedule D. Your Form 1099-B also presents information in as many as six different sections: short-term covered, short-term non-covered, long-term covered, long-term non-covered, an “unknown” section for transactions whose basis is not reported to the IRS and whose term is not known, and a new section called “Section 1256 Option Contracts.”

Given the nature and manner in which this information will be furnished to the IRS, it will be possible to have three 1099-Bs issued for one transaction. If the securities sold were comprised of covered and non-covered securities, and those covered securities were made up of both long- and short-term tax lots, your one transaction will yield three 1099-Bs: one for long-term covered securities; one for short-term covered securities; and a third for non-covered securities.

Typically, 1099-B forms are issued by February 15th each year. However, if this date lands on a weekend or holiday, your 1099-B will be available the following business day. For the 2014 tax year, forms will be made available by E*TRADE on or before February 17, 2015.

**Lot Selection Methods**

Lot selection is the method by which investors specify tax lots when selling positions. The method chosen can impact gains or losses and holding periods. E*TRADE offers the following lot selection methods for stocks trading in the U.S.:

<table>
<thead>
<tr>
<th>Lot Selection Method</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>First-In, First-Out (FIFO)</td>
<td>Lots with the earliest acquisition date are sold first. This is the default selection at E*TRADE.</td>
</tr>
<tr>
<td>E*TRADE, Last-In, First-Out (LIFO)</td>
<td>Lots with the most recent acquisition date are sold first.</td>
</tr>
<tr>
<td>Specific Lot</td>
<td>This method gives you the most control over the gains and losses you realize by allowing you to select the specific shares you’d like to sell each time you place an order to close a position.</td>
</tr>
</tbody>
</table>

Please note that FIFO is the only lot selection method available for RICs and ETF RICs, options, bonds, and fractional share liquidations.
**Wash Sales**

A wash sale occurs when a security is sold at a loss and, within a period of 30 days before or after the sale (the 61-day wash sale window), you reestablish a position in an identical or substantially identical security. If this occurs, some or all of the loss will be disallowed and may not be considered in calculating your losses for income tax purposes until the newly established position is closed.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1, 2014</td>
<td>You buy 100 shares of XYZ at a total cost of $400</td>
</tr>
<tr>
<td>March 5, 2014</td>
<td>You sell 100 shares of XYZ for proceeds of $250</td>
</tr>
<tr>
<td>March 20, 2014</td>
<td>You buy 100 shares of XYZ at a total cost of $270</td>
</tr>
</tbody>
</table>

In the above example, a wash sale has occurred. The $150 loss incurred on March 5th cannot be deducted from your taxes at this time. This is a "disallowed loss," and the $150 is added to the cost basis of the shares purchased on March 20th. The March 20 shares now have an adjusted cost basis of $420 ($270 + $150 wash sale adjustment).

The new regulations require brokers to track wash sales for all covered security transactions in identical securities (securities with the same CUSIP number) in the same account. However, all individual taxpayers are required to track and report wash sales for all security transactions in both substantially identical and identical securities across all the accounts they hold.

**Other Impacted Areas**

- **Account Transfers**
  
The reporting regulations also address how firms can maintain the integrity of cost basis information when transferring covered and non-covered securities between accounts at a single financial firm or at separate firms. In some cases (when dates are considered "unknown"), firms may use default dates; some of the most common of these are January 1, 1970, January 1, 1900, and January 1, 1901. There is a transfer statement firms are required to issue to the receiving firm when assets are transferred. There are also specific guidelines for gift transfers and inheritances. Although these rules are designed to make it easier for you, it is important that you understand that your new broker will never know that the cost basis information for a particular security is incorrect if all the required “data boxes” on the transfer statement are filled in with what appears to be valid data. Thus, we strongly recommend that you review your holdings on a tax-lot level before and after any transfer, and if the information appears incorrect, you should contact your prior broker immediately to send corrected information to your new broker.

- **Short Sales**
  
The regulations shift the timing of 1099-B reporting for short sale proceeds to the year in which the sale is closed. This enables E*TRADE to provide you and the IRS with the sale proceeds matched with the underlying cost basis when securities are used to close out the short sale. Short sales opened on or after January 1, 2011 will be reported in the year in which the short sale is closed.

- **S-Corporations**
  
Since January 1, 2012, brokers have been required to report gross proceeds and cost basis information for covered securities to customers that are S corporations.
**2014 Regulatory Changes**

Since January 1, 2014, brokers have been required to report gross proceeds and adjusted cost basis information for fixed income securities and options.

- **Fixed Income**
  
  For purchases made on or after January 1, 2014, most debt instruments will now be considered covered. This status applies to debt instruments that provide a single fixed payment or alternative payment schedule and have a yield that can be determined. Complex debt instruments without a fixed yield and fixed maturity date will not be categorized as covered until January 1, 2016.

  The following fixed income securities are exempt from the 2014 regulatory changes:
  
  - Bonds where the principal is subject to acceleration and that could be classified under Section 1272(a)(6)
    
    Examples: Some types of mortgage-backed and asset-backed securities, CMOs, and REMICs
  
  - Short-term obligations such as commercial paper and certain T-Bills
  
  - Factorable securities where principal repayment is subject to acceleration

- **Options**

  Options and futures contracts will be considered covered and require brokerage reporting for purchases made on or after January 1, 2014. Some securities, however, are exempt from the 2014 regulatory changes, including:

  - Options issued as part of a unit
  
  - Foreign currency options
  
  - Compensatory options
  
  - Commodity options

**Impact of Cost Basis Reporting for You**

The information in this white paper is intended to provide details about investment-related tax reporting changes and to ease the burden for tax filing. E*TRADE will provide tax forms with a detailed information summary that identifies all your closing reportable transactions at the lot level. You can download your Form 1099 to TurboTax or H&R Block on or before February 15th. If, however, February 15th lands on a weekend or holiday, 1099 forms will be available the following business day. For the 2014 tax year, forms will be made available on or before February 17, 2015.

**Some Final Words on Cost Basis**

In this white paper, we have highlighted some of the tax reporting changes for tax year 2011 and beyond. It is important that investors become familiar with these changes to be able to make decisions that could limit adverse impacts and maximize potential benefits. For additional information on tax reporting changes, please visit our Cost Basis Resource Center online at etrade.com/costbasis.