COST BASIS

This Cost Basis FAQ document will help you understand cost basis reporting requirements.

NOTE: These questions and answers are based on our understanding of the U.S. Treasury Department and IRS final cost basis reporting requirements (published by the IRS on April 17, 2013). They may be subject to varying interpretations, or changed by future tax regulatory guidance or legislation. Since Pershing does not provide financial, tax, legal or accounting advice, contact your financial, tax, legal or accounting advisor for more information and do not rely on this publication for any such advice.

OVERVIEW OF COST BASIS AND IMPLICATIONS

COST BASIS DEFINED

What is cost basis?

Cost basis is the original purchase price of a security, plus fees, commissions and transfer taxes, adjusted for a number of factors, such as corporate actions (e.g., stock splits and mergers), wash sales and adjustments to dividends (because of tax classification changes). Therefore, the gain or loss from the sale or other disposition of a security is generally calculated based on its adjusted cost basis.

What is the final IRS schedule for cost basis reporting?

The IRS timetable for cost basis reporting is:

- January 1, 2011—Stock in a corporation
- January 1, 2012—Mutual fund shares, including eligible dividend reinvestment plans (DRP) shares and exchange-traded funds (ETFs) that are treated like mutual funds
- January 1, 2014—Simple debt instruments (bonds) and options
- January 1, 2016—More complex debt instruments, including bonds with more than one rate, convertible bonds, stripped bonds or stripped coupons, payment-in-kind (PIK) bonds, foreign debt, foreign currency debt, some private issues and physical certificates

NOTE: Transfer statement reporting for simple debt and options is delayed to 2015. More complex debt including, but not limited to, real estate mortgage investment conduits (REMICs), widely held fixed investment trusts (WHFITs) and unit investment trusts (UITs), is delayed until 2017.

As a reminder, securities are considered covered under the cost basis rules if they are acquired on or after their applicable January 1 effective date, and noncovered if they are acquired before their covered effective date.

Why were the cost basis reporting regulations changed?

The Treasury and IRS changed the tax rules to maximize accuracy in the reporting of capital gains which, the IRS estimates, are underreported by clients. IRS studies have shown that approximately $6.7 billion over 10 years in tax dollars is lost annually as a result of inaccurate reporting of capital gains and losses. The rules are intended to ensure greater reporting accuracy and thus reduce lost tax revenues.

How have the cost basis changes impacted the industry?

The regulations transferred much of the responsibility for reporting cost basis and other information on taxable transactions involving covered securities from your clients to Pershing, although all clients retain overall responsibility for accurate reporting on their individual tax returns. However, broker-dealers (IBDs), issuers/transfer agents, mutual fund companies, advisors and registered investment advisors (RIA) have been affected in different ways. Broker-Dealers, including Pershing are responsible for IRS Form 1099-B (Proceeds from Broker and Barter Exchange Transactions) reporting (or acceptable substitute Form 1099-B reporting), generally they have been impacted the most.

How have the regulations changed the reporting of cost basis?

Basically, the rules require IBDs, advisors, RIAs, custodians and other financial services firms to report adjusted cost basis to the client and IRS for covered securities that are sold, exchanged or redeemed in U.S. taxable accounts (of non-exempt recipients). Previously, before the cost basis regulations, the taxpayer was responsible for reporting cost basis and gains and losses on applicable transactions.

COVERED VS. NONCOVERED SECURITIES

How do the rules define covered vs. noncovered transactions?

Covered securities are those acquired on or after the applicable dates outlined by the cost basis reporting legislation. Securities acquired before these dates are considered noncovered. For example, stock in a corporation acquired before January 1, 2011, is considered noncovered and its cost basis generally will not be reported to the IRS. Stock in a corporation acquired on or after January 1, 2011 (that is not eligible for the average cost method), is considered covered and its cost basis will be reported when sold.

TAX LOT DISPOSITION METHODS

What cost basis tax lot disposition methods does Pershing offer?

The disposition methods below, except for first in, first out (FIFO) using average cost, can be enabled either as a select or default disposition method. FIFO using average cost can be enabled only as an account default disposition method for mutual funds. It cannot be selected at the time that mutual fund shares are disposed of (by trade, transfer or exchange).

NOTE: Unit cost is determined by the total number of shares divided by the cost basis, including fees and commissions. It may not be equal to the market price on the date of acquisition.

› **First in, first out (FIFO):** The tax lot(s) with the oldest trade date(s) will be disposed of (sold, transferred or exchanged) first, based on the order of their acquisition

› **Last in, first out (LIFO):** The tax lot(s) with the earliest trade date(s) will be disposed of first, based on the order of their acquisition

› **High cost:** The tax lot(s) with the highest unit cost are disposed of first, whether the tax lot(s) are short-term or long-term. If short-term and long-term lots have the same unit cost, long-term lot(s) will be disposed first

› **High cost, long term:** The tax lot(s) with the highest unit cost, producing a long-term gain or loss, are disposed of first. Short-term shares with the highest unit cost will be disposed of, if no long-term shares are identified

› **High cost, short term:** The tax lot(s) with the highest unit cost, producing a short-term gain or loss, are disposed of first. Long-term shares with the highest unit cost will be disposed of, if no short-term shares are identified

› **Low cost:** The tax lot(s) with the lowest unit cost are disposed of first, whether the tax lots are short-term or long-term. If short-term or long-term lots have the same unit cost, the long-term lot(s) will be disposed of first

› **Low cost, long term:** The tax lot(s) with the lowest unit cost, producing a long-term gain or loss, are disposed of first. Short-term shares with the lowest unit cost will be disposed of, if no long-term shares are identified

› **Low cost, short term:** The tax lot(s) with the lowest unit cost, producing a short-term capital gain or loss, are disposed of first. Long-term shares with the lowest unit cost will be disposed of, if no short-term shares are indentified

› **Minimum tax:** Minimizes the tax impact on the account by taking losses first and gains last

– Short-term lots sold at a loss, from highest to lowest cost

– Long-term lots sold at a loss, from highest cost to lowest cost

– Short-term lots sold at not gain or loss

– Long-term lots sold at no gain or loss

– Long-term lots sold at a gain, from highest to lowest cost

– Short-term lots sold at a gain, from highest cost to lowest cost

› **FIFO using average cost (mutual funds and covered equity dividend reinvestments only):** Average cost per share for all tax lots of a security, even those no longer held by the client

– Upon disposition of mutual fund shares, the average cost basis per share is used

– Although the calculation is an average, the tax lots are disposed on a FIFO basis

Can the cost basis tax lot method be chosen or changed after the settlement date?

The cost basis method cannot be elected or changed after a trade has settled, whether it involves covered or noncovered securities. However, corrections after the settlement date will be permitted if the client can prove to Pershing's satisfaction that his or her instructions were not acted upon accurately or timely by the broker-dealer or Pershing.

TRANSFER STATEMENTS

What provisions related to transfer statements were included in the cost basis regulations?

The final regulations transferred much of the responsibility for maintaining cost basis information for covered securities from individual clients to broker-dealers and transfer agents. When a broker-dealer transfers covered securities to another broker-dealer, the transferring broker-dealer must furnish to the receiving broker-dealer a written statement with all required information necessary to allow the receiving broker-dealer to comply with cost basis reporting requirements. Statements required by this rule are generally due no later than 15 days following the transfer of the covered securities.

Is Pershing responsible for providing and receiving transfer statements?

Yes. Pershing is responsible for providing and requesting cost basis information on transfer statements for covered securities if such information is not sent and received on all free receives (a standard external receives into an account without a transfer reason code), account transfers and physical receives of securities. If Pershing does not receive a transfer statement, Pershing is required to make the request for the statement, but only one time. If, after the request, Pershing does not receive the cost basis information on the required transfer statement, the security will be marked and identified as a noncovered security for cost basis reporting purposes. In the event Pershing receives the required cost basis information at any time up to 18 months after the date of the original transfer to Pershing, Pershing will report the cost basis information to the transferee broker-dealer.

What is Pershing's responsibility with ensuring the accuracy of the information on transfer statements?

The delivering firm (Pershing) is fully responsible for the accuracy of the data.

› As required by the cost basis regulations, the following information (and, in certain cases, additional information) must be set forth in Pershing's transfer statements (which must be dated with the date they are furnished):
  - Securities being transferred
  - Total adjusted basis of the securities
  - Original date of acquisition
  - Transfer date
  - Settlement date for the transfer
  - Person furnishing the statement
  - Person receiving transfer statement
  - Owner(s) transferring the securities, and if different, the owner(s) of the securities after any transfer other than a sale, such as a transfer of gifted or inherited securities

› The information on transfer statements is coded for privacy reasons. The agreed upon codes can be used to avoid sending non-public information

Are transfer statements submitted to the IRS?

No. The regulations do not require that transfer statements be submitted to the IRS.

What are the transfer reasons in Asset Movement and how will they affect cost basis?

For third-party journals and client internal transfers (CITs), the regulations require the default classification for a transfer to be a gift (when a security is transferred to a different owner).

- The various transfer classifications are noted below accompanied by a brief description of Pershing's transfer statement and related reporting process:
- **Gift:** When the transfer reason gift is used, the system generally will calculate the gift's fair market value (FMV) for the assets as of the date that the assets move. The gift's FMV generally is the average of the high and low prices of the gifted security on the date of the gift because the regulations recognize that the FMV may not always be readily ascertainable. When the shares are received into the new account, they will be received in with the gift's FMV, transfer date, the donor's (original) adjusted cost basis and the donor's original acquisition date.

The reason that both values must be carried for a gift is that, upon selling the position, the regulations stipulate the following:

- If the position has depreciated in value, then Pershing must carry the date of the gift and the gift's FMV with the original basis
- If the position is sold for a gain, Pershing will report (on Form 1099-B) the cost basis using the donor's adjusted cost basis
- If the position is sold at a loss, Pershing will report (on Form 1099-B) the cost basis using the gift's FMV as the cost basis
- If the position is sold between the donor's adjusted cost basis and the gift's FMV, Pershing will report (on Form 1099-B) a zero gain/loss

The positions will transfer according to the account's default unless an alternative disposition method or specific lots are selected.

- **Divorce:** The positions will generally transfer according to the account's default unless an alternative disposition method or specific lots are selected. The adjusted cost basis and original acquisition date (of the transferring ex-spouse) will be transferred consistently with the disposition method or tax lots selected for the transfer.
- **Inheritance:** Upon entering the date of death into the Date of Death field when transferring assets, the system will calculate the cost basis based on the FMV as of the date of death, so long as the FMV is readily ascertainable. For retirement inherited accounts for which the date of death is available in Account Services, this information will be pre-populated. The inheritance fair market value generally is the average of the high and low price of the inherited security on the date of death.
- **Third-Party Transfer:** The positions generally will transfer according to the accounts default unless an alternative disposition method or specific lots are selected. The adjusted cost basis and original acquisition date will be transferred consistently with the disposition method or tax lots selected for the transfer.
- **Same Beneficial Owner:** The positions will transfer according to the account's default unless an alternative disposition method or specific lots are selected. The adjusted cost basis and original acquisition dates will be transferred consistently with the disposition method or tax lots selected for the transfer.

Can changes be made to the transfer reason for an asset movement previously processed?

Yes. If the transfer classification originally selected turns out to be incorrect and the transfer statement cost basis information needs to be changed, you must send a Service Center request to Cost Basis Reporting asking for an adjustment.

What does pending receipt mean?

Pending receipt is the 15-day time period allowed for the delivering firm or transfer agent to send the cost basis information. Pershing will mark the tax lot pending receipt until the basis is received. After the basis is received, the tax lot will be updated with the cost information and either the covered or noncovered indicators. If Pershing does not receive the basis after 15 days, the lot will be marked noncovered and Pershing will allow updates to the information.

WASH SALES

What is a wash sale?

A wash sale occurs when a covered or noncovered security is disposed of at a loss and an identical or a substantially identical security is purchased or acquired (in a taxable transaction) within the 30-day period before or after the sale. In that case, the loss is generally disallowed (in whole or in part, depending upon the quantity of the replacement security) and is used to adjust the cost basis and holding period of the replacement security.

What are the broker-dealer wash sale rules?

Generally, the broker-dealer wash sale rule prohibits a client from claiming a capital loss if the identical covered security (as determined by the CUSIP identifier) is purchased (or acquired in a taxable transaction) within the same account and within a period beginning 30 days before or after the covered security sale that results in a loss.

Consequently, the holding period of the replacement covered security includes the holding period of the covered security that was sold at a loss. As a result, the realized loss is disallowed in whole or in part, depending on the quantity of the newly acquired replacement shares of stock.

How are the effects of wash sales on cost basis reported to the IRS?

Beginning in tax year 2011, Pershing began tracking and reporting the effects of wash sales for the sale of covered stocks to the IRS on Form 1099-B. Broker-dealers (including Pershing), RIAs and other financial services providers are required to create and manage tax lots for all wash sale replacement securities. As securities become covered under additional phases of the legislation, Pershing will track and report any corresponding sales too. After 2011, the broker-dealer wash sale reporting rules applied to other subsequent categories of covered securities in 2012 and 2013 (or perhaps later) and will be reported to the IRS on Form 1099-B for the appropriate tax year.

How are wash sales tracked and cost basis disallowed losses reported?

Wash sales are calculated by Pershing's cost basis system and disallowed losses and adjusted trade dates are recorded in a unique field within this system. Pershing has identified approximately 40 scenarios that can trigger the wash sale rules.

SHORT SALES

How have cost basis changes impacted the reporting of short sales?

Since January 1, 2011, short sales must be reported for the tax year in which they are closed, rather than the year in which they are opened. It is now generally mandatory to report the cost basis as well as report whether the holding period is short or long term for closed short sales that are closed with the delivery of covered securities.

IMPORTANT CHANGES FOR DEBT INSTRUMENTS (BONDS)

How have the regulations changed the reporting of cost basis for debt instruments (bonds)?

Beginning January 1, 2014, the new tax rules require financial organizations to report the original or adjusted purchase price (cost basis) to investors and the IRS when debt instruments deemed simple (e.g., bonds, where a yield can be easily calculated) and options are sold, exchanged or redeemed. As a result, if your clients hold these covered, simple debt instruments or options, there will be important changes when they file their 2014 federal income tax returns. For the first time, your clients will see the cost basis of these investments reported on their Forms 1099-B for the 2014 tax year.

Purchases of these instruments on or after January 1, 2014, will be deemed covered and reported to the IRS when sold. As a result, financial organizations, including Pershing, are required to accommodate certain elections designated by the IRS in the regulations for the treatment of bond premiums and discounts. To select these elections and override the IRS defaults, advisors can update their clients' investment account settings (if they are properly authorized to do so). Clients should review the elections described in this document (see pages 10 and 11) with a tax professional, and provide written instructions so the advisor can update the account as appropriate.

Which debt instruments are subject to 2014 reporting?

Debt instruments that provide a single fixed income payment schedule, or one in which an alternative payment schedule for which a yield and maturity can be determined, are subject to 2014 reporting.

How will Pershing recalculate the cost basis for existing original issue discount (OID) bonds?

Pershing will calculate and re-adjust the cost basis for all open bonds originally issued at a discount (OID bonds), using the daily OID rate in conjunction with the acquisition premium or market discount adjustments. Previously, Pershing adjusted the cost on OID bonds using only constant yield, and reported the OID values on IRS Form 1099.

How should my clients prepare for this change?

Ensuring your clients are aware of the changes for bonds as early as possible—with accurate information—is vital to avoiding confusion. Importantly, please discuss bond changes as early as possible with clients, and long before 2014 tax season.

How did Pershing amortize and accrete debt previously before the 2014 changes?

Prior to January 1, 2014, your clients had flexibility on how they adjusted their cost basis on bonds. Pershing previously processed cost basis adjustments monthly on most bonds purchased at a discount or premium using the constant yield to worst call or maturity. Pershing provided these numbers as a guide or an estimate where you may be if you were reporting the bond using the same methodology. Pershing never provided the income to report for market discount and did not adjust the interest payments with the amortized bond premium.

What is the constant yield method?

A yield calculated using premium or discount paid in conjunction with the coupon payment received over the life of the bond. The earlier increments are typically smaller and they grow as the bond approaches maturity.

What is the ratable method?

To use the ratable method, determine the accretion amount from the purchase cost to maturity and divide the difference into equal amounts to be adjusted monthly over the life of the bond. This is also known as the straight-line method throughout the industry.

AVAILABLE BOND ELECTIONS AND DEFINITIONS

For investors, what are all of the bond elections specified by the IRS?

For debt instruments, there are four taxpayer elections on how to treat market premium and discount specified by the IRS that can be used to properly set up your clients' accounts. The following methods can be used either as a select or default disposition method.

Please review the full list below:

- **Bond Premium (per Internal Revenue Code (IRC) 171 and U.S. Treasury regulations 1.171-4):** This election allows an investor to amortize the premium on taxable bonds and apply the premium as an offset to interest income. The IRS instructed financial organizations to assume the investor has made this election. An investor can choose not to make this election and take the interest income at time of disposal.
  - If the investor does not takes this election, the investor is requesting that the broker not offset interest income with the premium paid for the bond.
- **Current Inclusion (per IRC section 1278[b]):** This election allows an investor to report accrued market discount annually as income and allows the financial organization to adjust the cost basis for the accruals. The default is not to report the market discount income annually on IRS Form 1099 INT.
  - If the investor selects current inclusion, the investor expects that the broker will include a portion of the market discount on Form 1099 INT/OID annually and adjust the cost basis until the bond reaches its par value.
- **Constant Yield (per IRC section 1276 [b][2]):** This election allows an investor to use the constant yield method when calculating accruals. The default is to calculate market discount accruals using the ratable or straight line method.
  - If the investor selects this election, the investor expects that the broker will calculate a yield that takes into consideration the value of money over time.
- **OID (per U.S. Treasury regulation 1.1272-3):** This is an election to include in gross income all interest that accrues on taxable bonds by using the constant yield method. The default is that the taxpayer has not made this election.
  - If the investor selects OID, he/she expects that the broker will amortize bond premiums, include market discount annually and use a constant yield when accruing market discount on taxable bonds.

How do bonds issued at a market premium amortize? Does an investor have to amortize?

Bond premium will continue to amortize utilizing constant yield. There is no change in calculation for non-taxable bonds; they will continue to amortize using constant yield to worst call or maturity. One calculation change at Pershing for taxable bonds is it will amortize to the maturity date rather than the worst call. In both cases for covered bonds (simple bonds purchased in 2014), your bond interest payments will include the amortized offset for tax reporting. Clients can decide not to amortize taxable bond premiums. However, if they choose not to amortize, the interest payment will not be offset by the amortized premium.

For advisors, what are the most important changes for bonds issued at a market discount?

There are big changes in bond calculations for bonds purchased at a discount in 2014. Before January 1, 2014, Pershing assumed the client had elected to treat the discount as income annually and assumed the client reported the income, so we were able to adjust the cost basis. However, the IRS default for bonds issued at a market discount is neither to report the accrued income annually nor to adjust the cost basis. So you have two different elections specific for market discount.

- **Accrue and report income annually:** If this election is not made Pershing will report original basis on the monthly client brokerage statement, NetX360 and when the bond is sold or matured. If the client would like to report the income annually on new bond purchases, he/she would have to elect in writing to report the income annually and a broker would be required to calculate the accruals and report them as income annually. This is often referred to as the current inclusion election.

- **Constant Yield Election:** In the past, when calculating accruals Pershing has used the constant yield method. This method takes into account the value of money over time and accrues less income in the beginning accrual periods and more in the final accrual periods. However, the IRS default is to accrete the market discount using the ratable method (also known as straight line). This method simply divides the accrual periods evenly over the life of the bond. The client can elect to use constant yield when calculating accruals. However, the client must make this election in writing. This election alone will not result in adjustments to cost basis, just in the accrual calculations used for calculating income versus gain or loss at time of disposal.

To keep the same methodology as in the past, the client needs to elect to pay income annually and use the constant yield method.

Another election available for all taxable bonds purchased at a premium and all discounted bonds is to treat all income as OID. When this election is chosen the client is electing to report the income annually utilizing the constant yield method and electing to amortize bond premium. However all income will be reported as OID on the Form 1099.

IMPACT TO INVESTORS

What do the cost basis changes mean for your clients?

Clients continue to be responsible for reporting cost basis to the IRS for all taxable securities—noncovered as well as covered—that are sold, exchanged or redeemed. In addition, your clients have to select the tax lot and disposition (or lot relief) method for each trade by three business days following the trade date or any earlier settlement date for the trade. If your clients do not select a disposition method, the default disposition method for the account will be used. Pershing's default method for dispositions is FIFO, which is the federally-mandated default disposition method. Also, Pershing applies the FIFO method for mutual funds, eligible DRPs and qualifying ETFs. Under the final cost basis reporting requirements, clients no longer have the option of postponing this decision beyond the settlement date, and Pershing must strictly enforce this rule. As a result, early tax planning is a must.

For bonds, what action steps should you communicate to your clients?

As part of your clients' annual tax reporting strategy—please continue to review the following items:

- Default disposition methods
- Cost basis bond elections and accrual methods

Since the rules may significantly affect your clients' tax reporting—and ultimately, their tax liability—we encourage you to speak to your clients as soon as possible about tax planning strategies. Your clients may require additional tax advice from a tax professional to select the most advantageous disposition method (or methods if they have multiple accounts) and bond elections.

In addition, review with your clients the default disposition method(s) (including standing instructions) to properly set up their accounts for compliance and tax planning purposes. There are several acceptable disposition methods that can be used. A selected disposition method can only be changed at the time of trade or transfer (of securities from the account). Unless otherwise instructed, the sale and delivery of stocks will be completed using the oldest tax lots first—i.e., these were purchased or acquired first.

For processing partial trades or deliveries, specific shares (or tax lots) may be selected at the time of trade or transfer. After the settlement date, however, no changes are permitted. Clients only have until the earlier of the settlement date or three business days to re-assign the tax lot(s) or make a change in the disposition method upon the sale, transfer or exchange of securities. Note that for non-trade activity, the deadline for tax lot(s) selection is always three business days from processing date.

Are my clients still required to report cost basis to the IRS?

Yes. Clients are still required to report information from the 1099-B section of their Tax and Year End Statement (or Pershing's substitute and composite 1099 form) on their individual income tax return, and include cost basis information for noncovered securities that a reporting broker-dealer is not required to report on Form 1099-B. As a result, clients must be able to verify, from their own records, all cost basis information reported on their tax returns.

Do the rules apply to foreign securities?

Yes. As of January 1, 2011, cost basis must be maintained and reported for stocks issued by foreign corporations that are acquired on or after that date. Such stocks are considered covered securities.

Do the rules apply to foreign accounts?

No. The cost basis reporting rules apply only to U.S. taxable accounts (of non-exempt recipients) which receive IRS Form 1099-B (or an acceptable substitute for Form 1099-B). The cost basis of securities acquired in accounts for citizens and tax residents of countries other than the U.S. are not required to be reported to the IRS. However, Pershing will continue to maintain and provide cost basis for virtually all accounts on Pershing's platform, whether or not there is a cost basis reporting requirement for the accounts.

Do the rules apply to IRA accounts?

No. The cost basis reporting rules apply only to U.S. taxable accounts (of non-exempt recipients) which receive IRS Form 1099-B (or an acceptable substitute for Form 1099-B). The cost basis of securities acquired in tax-deferred retirement accounts generally are not required to be reported to the IRS. However, Pershing will continue to maintain and provide cost basis for virtually all accounts on Pershing's platform whether there is a cost basis reporting requirement for the accounts.

ACCOUNT STATEMENT ENHANCEMENTS

To support cost basis reporting requirements, what enhancements have been made to Pershing's account statement?

To accommodate cost basis reporting requirements, Pershing introduced a number of enhancements to its award-winning account statement. All statements were enhanced to show the account default tax lot disposition method in the Client Service Information section. For example, this section would show FIFO if the account default was set to this method. In addition, firms that currently elect to show cost basis data on their clients' account statements will see additional enhancements.

IMPORTANCE OF ELECTRONIC DELIVERY

Why should my clients consider e-delivery of trade confirmations, tax documents and other account communications?

For tax lot selection after a trade is executed, your clients will have until the earlier of settlement date, or three business days, to select or change the selection of a tax lot disposition method or tax lot(s). To increase efficiency in this time-sensitive environment, clients will benefit from e-delivery of trade confirmations and other account documents. Taking advantage of this service eliminates the risk of slower delivery of paper documents with traditional mail. Clients can select e-delivery, through the NetXInvestor™ website.

Which account documents can be delivered electronically?

Account statements, trade confirmations and all 1099 tax statements can be delivered electronically. Tax documents are also available to view online. Additional documents, such as prospectuses, may also be delivered electronically.

How long will my clients have access to their accounts?

Your clients will have access to their account documents as long as they have a user ID for an account on Pershing's records. If your firm de-links an account from a user ID, or if the user ID is deleted from the system, your client will no longer have access to documents. When an account is purged from Pershing's systems, documents on NetXInvestor will no longer be available.

How long are electronic documents archived?

› Account statements are archived for 10 years

› Trade confirmations are archived for three years

› 1099 tax statements are archived for seven years

› Clients should be encouraged to save a copy of their documents on a local drive when a new document is made available

How can Pershing help our firm promote e-delivery?

Pershing has created a Marketing Toolkit that will assist you in promoting e-delivery. The toolkit contains statement inserts, messages, postcards, advertisements and customizable e-mails that can be shared with your advisors. It can be accessed via Resources in NetX360 by searching keyword "paperless" in the Marketing Center.

PERSHING PREPARATIONS AND RESPONSIBILITIES

What is Pershing's responsibility for reporting cost basis?

The federal income tax law, as changed by the Emergency Economic Stabilization Act of 2008, requires reporting broker-dealers, including Pershing, to maintain cost basis records for tax reporting purposes, transfer such information in accordance with special transfer statement rules and capture cost basis adjustments from corporate action issuers for covered securities.

In addition, affected firms, including Pershing, must provide clients with the ability to:

› Elect and change tax lot selection or lot relief methods

› Differentiate reporting and processing of covered and noncovered securities

› Calculate and report certain wash sales

› Change timing of short sale reporting and backup withholding

› Determine and monitor the effect of corporate actions on the cost basis of covered security positions

How involved is Pershing in future cost basis reporting developments?

At Pershing, we continue to proactively monitor cost basis developments about how these requirements impact the industry and investors on an ongoing basis. Pershing actively participates in cost basis discussions with the Securities Industry Financial Markets Association (SIFMA), the Investment Company Institute (ICI), Treasury, the IRS and the U.S. Government Accountability Office (GAO). The GAO has oversight jurisdiction regarding the IRS's implementation of the cost basis regulatory scheme, and it reports to Congress on such implementation.

NETX360 COST BASIS ENHANCEMENTS

What NetX360 functionality has been added for reporting (simple debt instruments [bonds] and options)?

The following highlights the key system changes. As we implement these updates, it will be necessary to make changes to multiple screens in NetX360 and NetXInvestor. We will also be updating our standard files and XML layouts. We will communicate with you before making these changes, so you can plan for them.

As a reminder, cost basis tax regulations are currently scheduled to be phased in over six years. The effective dates for which cost basis must be reported are as follows:

Type	Description	Effective Date*
Stocks	Corporate stock	January 1, 2011
Mutual Funds	All mutual fund shares or stock eligible for dividend DRPs	January 1, 2012
Debt and options	Debt was broken into two segments simple and complex, principally debt securities and options	January 1, 2014 (simple debt) 2016 (complex debt)

* Cost basis reporting will be for securities purchased on or after the above dates except for mutual funds or DRPs for which the single account election is made.

NetX360—new fields/columns

Realized Gains/Losses (RGL) Screen
New Columns: Reportable Income, Disallowance, Year to Date (YTD) Reportable Income

Realized Gains/Losses (RGL) Tax Lot Details Popup
New Fields: Reportable Income, Disallowance, YTD Reportable Income Adjustment, Bond Election, Acquisition Premium, Accrued OID, Non-Qualified Stated Interest

New Field Label: Amortization Yield > Bond Rate

Unrealized Gains/Losses (RGL) Screen
New Columns: Deferred Income, YTD Reportable Income Adjustment

Unrealized Gains/Losses (RGL) Tax Lot Details Popup
New Fields: Bond Election, Deferred Income, YTD Reportable Income Adjustment, Unused Amortization, Acquisition Premium, Accrued OID, Non-Qualified Stated Interest

New Field Label: Amortization Yield > Bond Rate

FEES

What does Pershing provide as part of its basic cost basis package?

Pershing provides a basic cost basis package at no extra cost to introducing broker-dealer relationships. It covers all of the accounts that Pershing does for 1099-B reporting and includes:

- Capturing cost basis from 2011 forward
- Allowing for 10 account or office default methods
- Having the advisor or broker-dealer select tax lots and a tax disposition method at time of disposition
- Reporting covered tax lots on Form 1099-B and trade confirmations
- Displaying tax lots of disposed securities in the Activity screen in NetX360
- Displaying of tax lots in the Holdings Position screen in NetX360

Additional cost basis services for a fee include:

› Realized and unrealized gain and loss information on statements and NetX360

› Noncovered (not reported lots) in a realized gain and losses section of the 1099-B

For more information, please contact the Asset Services Client Services Team.

COST BASIS TOOLS AND RESOURCES FOR FIRMS AND ADVISORS

Where can I find information on cost basis from Pershing?

For more information about cost basis changes, please visit the Cost Basis Center, available under the Resources tab in NetX360 (search keyword “cb-info”). In the Cost Basis Center, Pershing’s cost basis related tools and information are available, including communications, webcast replays and other useful information. In addition, Pershing regularly provides the latest information through Pershing Updates.

If you have specific questions about Pershing’s cost basis initiative, you may also contact the Asset Services Team.

Has Pershing produced any materials on the rules that can be shared with my clients?

Pershing developed a comprehensive set of resources to help you communicate cost basis changes—from statement inserts to customizable letters. To access these resources, please visit the Cost Basis Center in NetX360 (keyword “cb-info”).

A few of our client communications include:

› **Sample Client Letter.** To help your clients understand tax and cost basis reporting requirements, a customizable letter is available. Visit the Cost Basis Center in Resources (keyword “cb-info”) for a copy of the letter.

› **Account Statement Insert “2014 Cost Basis Changes for Bonds and Account Elections.”** Your clients received this insert in their September 2014 statements, which outlined the important cost basis reporting changes that related to debt instruments (bonds) in a taxable account. Please visit the Cost Basis Center in Resources (keyword “cb-info”) for the insert.

› **Account Statement Insert “2013 Tax and Cost Basis Reporting.”** Your clients received this insert in their December 2013 statements, which outlined the basics of the cost basis reporting requirements. Please visit the Cost Basis Center in Resources (keyword “cb-info”) for the insert.

› **Understanding the Cost Basis Reporting Regulations.** This guide focuses on the following types of financial services firms, which were affected by the new law. These included, but were not limited to, securities clearing organizations, brokers and broker-dealers, banks, mutual fund companies, custodians, issuers/transfer agents, (corporate stock) plan administrators, advisor firms and registered investment advisory firms.

› **Cost Basis vs. Third-Party Performance Reporting Guide.** This guidebook helps advisors and Operations department employees at IBDs and RIAs understand the differences in reporting details between Pershing’s systems and other third-party cost basis reporting systems (CBRS).

› **Pershing’s Tax Guide and mytaxhandbook.com.** For you, your clients and their tax professionals, the Tax Guide, at mytaxhandbook.com, contains important information about reading tax statements and provides pertinent tax reporting instructions and requirements. No login or registration is required to download the guide via mytaxhandbook.com.

What training is available?

Training on the cost basis changes to NetX360 is available via the NetX360 Learning Center (click Resources > Learning Center). The cost basis changes are now incorporated within the following courses: Cost Basis Initiative—Phase I, Cost Basis Initiative—Phase II, Order Entry, Opening Accounts and Processing Documents, Updating Accounts in Account Services and Initiating Outbound Transfers. To view the schedule of class dates and times, click the eLearning Calendar link in the Learning Center.

What user information is available? Where can I locate it?

Documentation on the changes to NetX360 for the cost basis rules is available on the NetX360 Learning Center (click Resources > Learning Center). You can search for cost basis to see a variety of documents related to Pershing's cost basis support.

From the Learning Center you can also access Task References. All Task References related to cost basis have been updated to reflect the new functionality. In addition, the guide NetX360® Support for New Cost Basis Reporting Rules provides an overview of the changes to NetX360.

MORE INFORMATION

ADDITIONAL RESOURCES FROM THE IRS

Where can I find the IRS official FAQ document?

To obtain a copy of the IRS official FAQ document, visit the IRS website at irs.gov.

Will the IRS impose penalties for erroneous cost basis reporting?

Generally, yes. A fine can be assessed for each misreported cost basis transaction. However, since a single transaction can require up to three separate reports, the fine could be much more. For more information, please see IRC Sections 6721 and 6722.

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