

# SPECIAL REPORT

## The 1099-B Problem

Why IRS Regulations Have Failed to Meet Cost Basis Reporting Needs



Published By: Armen Computing, Ltd, creators of TradeLog Software

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Software for Active Traders

# *The 1099-B Problem: Why IRS Regulations Have Failed to Meet Cost Basis Reporting Needs*

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## **BACKGROUND:**

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Armen Computing, Ltd. publishes TradeLog software, a leading tax accounting software designed specifically for active traders and investors. Since 1999 TradeLog has been dealing with the complex IRS rules for traders in securities, especially wash sales. Over the years, TradeLog has worked to not only provide an automated solution for identifying and adjusting wash sales, but also to educate traders and investors about the complexities of wash sales and other tax reporting requirements they face. TradeLog software has helped thousands of active traders and investors generate accurate capital gains tax reporting.

Over the past two years the TradeLog software team has become acutely aware of the problems resulting from new 1099-B requirements. They have worked as an advocate for traders in identifying 1099-B problems and trying to bridge the gap between 1099-B reports and accurate taxpayer reporting needs. This report is a culmination of their review of hundreds of actual 1099-B reports and supporting documentation by brokerage firms, in addition to a thorough review of the IRS requirements for both brokers and taxpayers. This knowledge, combined with the real experience of supporting active traders in generating capital gains tax reporting under current regulations, has provided tremendous insight on the 1099-B problem.

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## SUMMARY

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Beginning with the 2011 tax year, brokerage firms began providing new 1099-B reporting to comply with IRS regulations. These new 1099-B regulations require brokers to report cost basis for some securities, as well as limited wash sale adjustments. Congress had mandated this new reporting with the intent of closing the tax gap resulting from the inaccurate reporting of capital gains and losses by traders and investors. In theory, the new 1099-B reporting would make it easier to file an accurate Schedule D – the broker would now provide both the sale proceeds and cost basis for all trades along with identification of wash sales. However, there are serious problems that have resulted from the new 1099-B changes which this special report will highlight.

New 1099-B reporting regulations missed the mark in what is needed for accurate tax filing. Currently there are two sets of rules: one for taxpayers and one for brokers, and the rules have major differences. These differences result in greater burden for taxpayers who desire to accurately report taxes. Erroneous reporting of 1099-B by some brokerage firms has created an additional complication and effects the accuracy of countless numbers of tax returns. And flaws in the 1099-B requirements make accurate accounting and tax reporting nearly impossible. These problems will be explained in detail. We will also expose a major failure of the regulations in achieving the intended purpose of cost basis legislation.

Are the current regulations and requirements simply the best possible solution? Is there a better way to provide taxpayers with the information they need for accurately reporting capital gains and losses? This report will answer those questions and make recommendations for current and long-term solutions.

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***Flawed 1099-B requirements reveal the IRS has missed the mark in meeting the needs for accurate tax reporting.***

## SECTION 1: DIFFERING RULES FOR TAXPAYERS AND BROKERAGE FIRMS

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The IRS currently has differing regulations for reporting capital gains and losses from the sales and trades of investment property by taxpayers on Schedule D Form 8949, and by brokerage firms on Form 1099-B. Primarily these differences deal with wash sales. We have reviewed IRS Publication 550 and compared it with the IRS Instructions for Form 1099-B and have found some key differences:

### *Differing Rules: Reporting Securities*

**The problem:** Until 2014 tax year, brokers are not required to report all securities traded in the tax year on Form 1099-B. This poses challenges for taxpayers who traded in securities not covered by 1099-B reporting requirements. For example, for the 2012 tax year the 1099-B instructions, page 6 states:

"A specified security is any share of stock (or any interest treated as stock, such as an American Depositary Receipt) in an entity organized as, or treated for federal tax purposes as, a corporation (foreign or domestic). For this purpose, a security classified as stock by the issuer is treated as stock. If the issuer has not classified the security, the security is not treated as stock unless the broker knows that the security is reasonably classified as stock under general federal tax principles."

Essentially most brokers interpret this to mean that all shares of stock in equities, mutual funds, dividend reinvestment plans (DRIPs), and most ETFs are to be reported as covered securities. Some ETFs are not deemed to be covered and, most notably, option trades are not covered.

In addition, cost basis must only be reported by the broker for trades purchased on or after January 1 of the year they are covered – brokers are not required to report any cost basis for securities purchased prior to January 1, 2011. Taxpayers are of course required to report all trading activity.

**Why it matters:** Many taxpayers may receive a 1099-B that reflects only some of their trading activity. Which raises the question, how do they report the non-covered securities on Form 8949? The obvious answer is that they must generate this reporting independently as directed by the IRS instructions. Sadly though, that "obvious answer" often is not so obvious to many taxpayers. A great number of taxpayers do not fully understand

*Taxpayers may fail to report some taxable trade activity that is not reported on the 1099-B.*

reporting requirements and erroneously think that 1099-B is all they need. Therefore it is very possible that some taxpayers fail to report all of their trading activity.

### *Differing Rules: Wash Sales*

**The problem:** There are significant differences in wash sale reporting requirements for taxpayers and brokers. The IRS requirements for 1099-B reporting exempt brokers from identifying all wash sales that may occur.

The IRS Instructions for broker reporting on 1099-B pages 7 and 8 state:

“Report any loss disallowed under section 1091 only if both the sale and purchase transactions occur in the same account with respect to covered securities with the same CUSIP number. You are permitted, but are not required, to report in box 5 all loss disallowed under section 1091. For example, you may report a disallowed loss even though a security is sold in one account and repurchased in a different account. Increase the adjusted basis of the acquired securities by the amount of the disallowed loss reported in box 5.”

IRS Publication 550 states the following requirements for taxpayers on page 59:

“You cannot deduct losses from sales or trades of stock or securities in a wash sale unless the loss was incurred in the ordinary course of your business as a dealer in stock or securities.

“A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:

1. Buy substantially identical stock or securities,
2. Acquire substantially identical stock or securities in a fully taxable trade,
3. Acquire a contract or option to buy substantially identical stock or securities, or
4. Acquire substantially identical stock for your individual retirement account (IRA) or Roth IRA.

“If you sell stock and your spouse or a corporation you control buys substantially identical stock, you also have a wash sale.”

***Brokers are not required to identify and adjust for all wash sales on the 1099-B.***

In plain English this means that the broker is only required to adjust wash sales that occur on trades of the identical CUSIP and within the same account. All other wash sale adjustments are the responsibility of the taxpayer.

**Why it matters:** The 1099-B was intended to provide the taxpayer with the information needed for easier tax reporting. However, because the broker is exempt from reporting all wash sales, the 1099-B wash sale adjustments are often incomplete. Especially if any of the following circumstances apply to the taxpayer:

1. The taxpayer has more than one trading account in which they trade the same or substantially identical securities.
2. The taxpayer's spouse trades the same or substantially identical securities in a separate account.
3. The taxpayer controls a corporation which trades the same or substantially identical securities.
4. The taxpayer has an IRA account in which they trade the same or substantially identical securities.
5. The taxpayer trades different option contracts on the same underlying security (technically considered different CUSIPs by the broker).
6. The taxpayer trades stocks and options on the same stock.
7. The taxpayer trades a security which undergoes a corporate action resulting in a change in CUSIP.

If one or more of those circumstances apply a taxpayer cannot rely solely on the 1099-B but is required to report additional wash sale adjustments. Those additional wash sale adjustments can have major consequences.

Consider the example scenario on the next page:

*There are at least seven situations where a taxpayer cannot rely on the 1099-B for all wash sale adjustments.*



**Example Scenario:**

The taxpayer has **two trading accounts** at **different brokerage firms**.

In **Account A** the taxpayer makes the following trades:

May 11, 2012 – Purchase 100 shares of AAPL for \$56,671.00

May 14, 2012 – Sell 100 shares of AAPL for \$55,822.00, resulting loss of (\$849.00)

The taxpayer does not make any other trades in AAPL in Account A within 30 days before or after that loss. The broker will report this trade on the 1099-B as an allowed loss.

In **Account B** the taxpayer makes the following trades:

May 23, 2012 – Purchase 100 shares of AAPL for \$57,056.00

June 21, 2012 – Sell 100 shares of AAPL for \$57,767.00, resulting in a gain of \$711.00

June 28, 2012 – Purchase 100 shares of AAPL for \$56,905.00

The taxpayer has no losses for AAPL in Account B. The broker will report the gain of \$711.00 on the 1099-B. The 100 shares purchased on June 28, 2012 will be carried forward and reported in the year of their disposition.

Based on what the broker will report to the IRS in this example, the following would be the result:

Account A – capital loss of (\$849.00)

Account B – capital gain of \$711.00

Total net capital loss of (\$138.00)

The taxpayer is responsible to report to the IRS the correct accounting of these trades including the wash sale that occurred across the accounts. This means for our example above:

- The (\$849) loss in Account A was disallowed because within 30 days the taxpayer purchased shares of the same security (on May 23).
- The cost basis of the shares purchased on May 23 are now increased by \$849. And as a result, the sale on June 21 now creates a loss of (\$138.00).
- In addition, because shares were again purchased within 30 days (on June 28), the (\$138) loss also is disallowed because of the wash sale rule. The shares purchased on June 28 are adjusted for the disallowed amount.

***Taxpayers must identify and adjust for additional wash sales not reported on the 1099-B.***

- Therefore, the taxpayer actually has a taxable capital gain of \$0.00 for this trade scenario.

The taxpayer's 1099-B information would indicate a (\$138) capital loss but *legally they do not have an allowable loss in the tax year*. The taxpayer is required to make all of these additional adjustments!

Note that these additional adjustments not only affect the trades reported on two 1099-B reports for 2012, but will also affect the a future tax year 1099-B for Account B when the taxpayer sells the 100 shares of AAPL.

This is a very simple scenario involving only five executed trades and all for the same quantity of shares. Taxpayers are expected to make these additional adjustments when required, and often that involves hundreds or even thousands of trades and varying share quantities.

In addition, special rules exist for wash sales that result from securities purchased in IRA accounts. Since these rules call for the permanent disallowance of the loss, such wash sale adjustments almost always affect the tax liability of the taxpayer.

The IRS instructions for Form 8949 reporting by the taxpayer technically require the taxpayer to report the 1099-B reported amounts for each trade, then make adjustments to each trade, then code those adjustments. In essence, the IRS wants the taxpayer to do double the reporting: list the incorrect amounts from the broker, then make the correct adjustments and report those. This increased tax reporting burden has proven to be a difficult to impossible task for many taxpayers.

What if the taxpayer fails to make the additional wash sale adjustments required by the IRS when they complete form 8949? If they only report 1099-B information without additional adjustments it is likely they will overstate their losses to the IRS.

### *Differing Rules: Constructive Sales and Other Complex Situations*

**The problem:** IRS regulations outline rules for constructive sales which affect taxpayers in various situations. The constructive sale rule can create a taxable sale on a date other than that in which an actual sale occurs. Holding periods are also affected by the constructive sale rule. In addition, IRS Revenue Ruling 2002-44 states that a short sale which is closed at a gain may be reported differently than if it were closed at a loss.

*Brokers are exempt from accounting for other complex tax rules affecting traders and investors.*



Brokers are exempt from applying the constructive sale rule on 1099-B reporting. This is made clear in the IRS instructions for 1099-B on pages 2, 6, and 7. In addition, page 6 of the instructions lists many other reporting rules that do not apply for 1099-B:

"You are not required to consider other transactions, elections, or events occurring outside the account when determining whether the gain or loss on the sale is short-term or long-term. You are also not required to apply section 1259 (constructive sales), 475 (mark-to-market method of accounting), 1092 (straddles), 1233(b)(2) (short sales), 1296 (mark-to-market method of accounting for marketable stock in a passive foreign investment company), 852(b)(4)(A), 857(b)(8), 852(b)(4)(B) (regulated investment company and real estate investment trust adjustments), and Regulations section 1.1221-2(b) (hedging transactions)."

**Why it matters:** In any of these situations the 1099-B reporting becomes inaccurate for taxpayer reporting use. In addition, taxpayer reporting burden is increased when they must sift through inaccurate information to identify and make required adjustments.

Consider for example a simple application of Revenue Ruling 2002-44:

**Example Scenario:**

The taxpayer made the following trade:

- Dec. 26, 2012 – Sold short 1,000 shares of LNKD for \$115,001.43
- Dec. 27, 2012 – Bought to cover 1,000 shares of LNKD for \$114,616.99, resulting in a gain of \$384.44

Because the broker does not apply the constructive sale rule, this trade will not be reported on the 1099-B for the 2012 tax year. This is because the IRS states that short sales are reported as sold or disposed of on "the date the security was delivered to close the short sale." (IRS Instructions for 1099-B page 2). The delivery event typically occurs on the settlement date of the closing position, when the shares were delivered to the broker to replace the property borrowed by the broker. Since settlement did not occur on the buy to cover position until January 2<sup>nd</sup> of the following tax year, the broker does not report the trade in the 2012 tax year.

However the taxpayer must apply Revenue Ruling 2002-44 which explains that, since this trade resulted in a gain, a constructive sale is considered to have occurred when the property was acquired – the trade date of December 27<sup>th</sup>. Therefore the taxpayer is required to report this trade as being closed with a taxable gain in the 2012 tax year.

*Innaccurate 1099-B reports are useless to many taxpayers.*

*The new 1099-B reporting fails to make tax reporting easier or more accurate for many traders and investors.*

In our example above the taxpayer will be reporting a security in 2012 tax year that was not reported by the broker. In addition, their 2013 tax year 1099-B will report the security. This results in reconciliation differences between the reporting for both tax years.

In addition, there may be other short sales that occurred throughout the year and closed at gains. The date which those trades are reported would technically be incorrect on the 1099-B. Since brokers are not required to report these constructive sales, it is the responsibility of the taxpayer to analyze and identify these sales, and then report them correctly on Form 8949.

The new cost basis legislation was intended to make reporting easier. However the new 1099-B requirements have failed in that regard. Taxpayers must now try to use the 1099-B – reported by one set of rules – to complete a Form 8949 based on another set of rules. The burden of reporting is greater for individuals who want to report taxes accurately.

## SECTION 2: ERRONEOUS 1099-B REPORTING BY BROKERAGE FIRMS

Brokerage firms have struggled with the new 1099-B requirements. Not only do they struggle to provide a timely 1099-B but in many cases there are errors in the reporting they provide. We have documented many errors in the first two years of the new 1099-B. Admittedly things have improved in 2012. But there still remains some serious concerns.

*Serious errors have been found in 1099-B reporting.*

### Wash Sales Incorrectly Adjusted on Short Sales

**The problem:** When a wash sale is triggered by a short sale, some brokers incorrectly adjust the sale proceeds of the short sale instead of the cost basis.

Consider the example below for a series of short sales that were made in a brokerage account for ticker GMCR. Figure 2.1 shows the trade history reported by the broker for four trades of GMCR. Figure 2.2 consolidates these facts, note that this is actual trade history prior to any adjustments. (Dates shown in the trade history are the trade dates; tax reporting shown in Figures 2.3 and 2.4 will utilize specific IRS rules for the dates short sales are reported on and thus will be different.)

Figure 2.1

From Broker Trade History Report

Date	Trade Type	Symbol	Company Name	Shares	Price	Amount	Comm	Fees	Settlement Date	Notes
01/18/2012	YOU SOLD SHORT SALE	GMCR	GREEN MTN COFFEE ROASTERS INC	-400.000	\$49.75	\$19,891.66	\$7.95	\$0.39	01/23/2012	First trade closed at a loss of (\$312.25)
01/18/2012	YOU BOUGHT SHORT COVER	GMCR	GREEN MTN COFFEE ROASTERS INC	+400.000	\$50.4899	-\$20,203.91	\$7.95		01/23/2012	
01/19/2012	YOU SOLD SHORT SALE	GMCR	GREEN MTN COFFEE ROASTERS INC	-300.000	\$52.11	\$15,624.74	\$7.95	\$0.31	01/24/2012	Second trade closed at a loss of (\$4.70)
01/20/2012	YOU BOUGHT SHORT COVER	GMCR	GREEN MTN COFFEE ROASTERS INC	+100.000	\$52.05	-\$5,212.95	\$7.95		01/25/2012	

Figure 2.2

Shares	Bought Cover	Sold Short	Proceeds	Cost Basis	Gain / Loss
400	1/18/2012	1/18/2012	\$19,891.66	\$20,203.91	(\$312.25)
100	1/20/2012	1/19/2012	\$5,208.25	\$5,212.95	(\$4.70)

Based on the actual trade history we note the first trade resulted in a loss of (\$312.25). Since another short sale was entered into within 30 days of that loss (in this case on 1/19/2012), this new short sale would trigger a wash sale according to IRS rules – see IRS publication 550 page 60 “Short Sales”.

Please note: there are additional trades of GMCR which also occurred within 30 days of this example, therefore the entire amount of (\$312.25) is considered to be disallowed. For simple example purposes we will only highlight the two trades shown. The 100 shares sold short on 1/19/2012 would disallow only one fourth of the total loss, equaling \$78.0625.

Figure 2.3 reveals that the broker does report the (\$312.25) loss as disallowed because of a wash sale. However, notice that the corresponding adjustment to the 100 shares has been made to the sale proceeds, which they now report as \$5,130.18 (\$5208.25 - \$78.07). This adjustment is incorrect based on IRS rules. Both Publication 550 (page 59) and the Instructions for 1099-B reporting (page 7) state that the adjustment of the disallowed loss is made by increasing the cost basis.

**Figure 2.3**

8 Description, 1d Stock or Other Symbol, CUSIP							From Broker 1099-B	
Action	1a Date of Sale or Exchange	1b Date of Acquisition	1e Quantity Sold	2a Sales Price of Stocks, Bonds, etc. (a)	3 Cost or Other Basis (b)	Gain/Loss (-)	5 Wash Sale Loss Disallowed	
GREEN MTN COFFEE ROASTERS INC, GMCR, 393122106								
Sale	01/23/12	01/18/12	400.000	19,891.66	20,203.91	-312.25	312.25	
Sale	01/25/12	01/20/12	100.000	5,130.18	5,212.95	-82.77	82.77	

The correct method of adjusting the wash sale in this example is illustrated in Figure 2.4, which is generated by TradeLog software. Notice that the wash sale amount is properly adjusted by increasing the cost basis of the 100 shares, the sale proceeds remain the same as the actual trade history shown in Figure 2.2 above.

**Figure 2.4**

From TradeLog Software Reporting						
(a) Desc of Property (Example: 100 sh. XYZ Co.)	(b) Date acq (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price	(e) Cost or other basis	(f) GAIN or (LOSS) Subtract (e) from (d)	
1) 400 (S) GMCR	1/18/2012	1/23/2012	\$19,891.66	\$20,203.91	(\$312.25)	
Wash Sale Adj - [line 2] 100 (S) GMCR		1/19/2012		(\$78.06)	\$78.06	
Wash Sale Adj - [line 3] 200 (S) GMCR		1/19/2012		(\$156.13)	\$156.13	
Wash Sale Adj - [line 4] 100 (S) GMCR		1/20/2012		(\$78.06)	\$78.06	
2) 100 (S) GMCR	1/20/2012	1/25/2012	\$5,208.25	\$5,291.01	(\$82.76)	
Wash Sale Adj - [line 4] 100 (S) GMCR		1/20/2012		(\$82.76)	\$82.76	

**Why it matters:** It could be argued that decreasing the sale price by the disallowed loss equates to the same end result as increasing the cost basis. Although this is true, and in the example the resulting loss for the 100 shares after adjustment is essentially the same, the fact is that this method is incorrect.

The IRS has clearly explained how wash sale adjustments are made. By erroneously decreasing sale proceeds the broker makes it difficult to impossible for a taxpayer to verify and reconcile their 1099-B reporting with actual trade history. Accurate tax filing cannot be done using the 1099-

B reporting in such cases. In addition, the IRS will notice that taxpayers who report correctly will often report higher sale proceeds on covered securities than were reported by brokers who use this incorrect method.

Only some brokers are using this incorrect method of adjusting wash sales on short sales. In fact one major broker used the incorrect method for 2011 tax year and then commendably changed their system to use the correct adjustment method for the 2012 tax year.

### Inconsistent 1099-B Reporting

**The problem:** Interpretations of what securities are covered and non-covered seem to vary between brokers. Note for example Figure 2.5 where one broker reported SPDR Gold Trust (GLD) as “Noncovered” in 2012. Compare Figure 2.6, where a different broker has reported the exact same security as Covered, “cost basis is reported to the IRS”.

Figure 2.5

2012 Tax Reporting Statement							1099-B
2012 Proceeds From Broker and Barter Exchange Transactions							
Security Description (Line 8)	CUSIP/ISIN	Symbol (Line 1d)	Quantity (Line 1e)	Transaction Description	Date of Sale or Exchange (Line 1a)	Proceeds (Line 2a)	
SPDR GOLD TRUST	78463V107	GLD	80	Sale	09/24/2012	13,672.61	
			20	Sale	12/19/2012	3,234.16	
				Security Subtotal		16,906.77	

**Noncovered Securities** (circled in red)

*From Broker 1099-B Statement*

Shares purchased on 9/24/2012 (arrow pointing to 80 shares)

Figure 2.6

FORM 1099-B* 2012 Proceeds from Broker and Barter Exchange Transactions										
Short-term transactions for which <b>basis is reported to the IRS</b> --report on Form 8949 with Box A checked and/or Schedule D, Part I (This Label is a Substitute for Boxes 1c & 8)										
(IRS Form 1099-B box numbers are shown below in bold type)										
8 Description, 1d Stock or Other Symbol, CUSIP	1a Date of Sale or Exchange	1b Date of Acquisition	1e Quantity Sold	2a Sales Price of Stocks, Bonds, etc. (a)	3 Cost or Other Basis (b)	Gain/Loss (-)	5 Wash Sale Loss Disallowed	4 Federal Income Tax Withheld	13 State Tax Withheld	15 State Tax Withheld
<b>SPDR GOLD TR GOLD SHS, GLD, 78463V107</b>										
Sale	06/19/12	03/16/12	100.000	15,777.69	16,729.53(h)	-951.84	951.84			
Sale	07/03/12	03/22/12	100.000	15,701.60	16,259.19(h)	-557.59				

*From Broker 1099-B Statement*

**Why it matters:** Inconsistent reporting causes more confusion for tax payers. In addition such inconsistencies make it extremely difficult for third party software programs to verify and reconcile independent trade history with the 1099-B. Finally, if one broker is incorrect in their interpretation then they would be subject to IRS penalties for failing to report correctly.



## Anomalous and Unexplainable 1099-B Reporting

**The problem:** Start examining 1099-B reports closely and it will not take long before you find anomalies that are difficult or even impossible to explain.

Consider the example shown in Figure 2.7, taken from a major broker's 1099-B. The circled trade seems rather normal at first glance. But pull out your calculator and take another look. When you subtract the cost basis from sales proceeds the result is a loss of (\$150.53). Note that the broker reports a disallowed loss of \$172.29 as a result of a wash sale. How can the disallowed loss be higher than the calculated loss?

Figure 2.7

Proceeds from Broker Transactions — 2012 (continued)				From Broker 1099-B		Form 1099-B	
Department of the Treasury-Internal Revenue Service				Copy B for Recipient (OMB No. 1545-0715)			
1c-Type of gain or loss: Short-term (Report on Form 8949, Part I, with <b>Box A</b> checked.)				SHORT-TERM HOLDING PERIOD			
6b-Basis reported to IRS				COST BASIS IN THIS SECTION IS REPORTED TO THE IRS			
8-Description	CUSIP Number	1b-Date of acquisition	1a-Date of sale or exchange	2a-Sales price of stocks, bonds, etc. (less commissions and options premiums) 1e-Quantity sold	3-Cost or other basis	5-Wash sale loss disallowed	4-Federal income tax withheld
DIREXION SHS ETF NEW DAILY SMALL CAP	25459W110	\$ 02/17/12	\$ 02/17/12	\$ 27,219.14 1,500.00	\$ 27,505.68	\$ 286.54	\$ 0.00
DIREXION SHS ETF NEW DAILY SMALL CAP	25459W110	\$ 02/17/12	\$ 02/17/12	\$ 45,692.73 2,500.00	\$ 45,843.26	\$ 172.29	\$ 0.00
DIREXION SHS ETF NEW DAILY	25459W110	\$ 02/17/12	\$ 02/17/12	\$ 54,740.06	\$ 55,218.46	\$ 478.40	\$ 0.00

This broker includes supplementary Realized Gain or Loss reporting to clients along with the 1099-B. That supplementary reporting, shown in Figure 2.8, contains the same anomaly; in fact for the same trade it reports a realized gain of \$21.76 for the trade in question. No explanation is evident regarding this reporting.

Figure 2.8

Short-Term Realized Gain or (Loss) (continued)				From Broker G&L Reporting				
This section is for covered securities and corresponds to transactions reported on your 1099-B as "cost basis is reported to the IRS." Report on Form 8949, Part I, with Box A checked.								
Description	CUSIP Number	Quantity/Par	Date of Acquisition	Date of Sale	Total Proceeds	Cost Basis	Wash Sale Loss Disallowed	Realized Gain or (Loss)
DIREXION SHS ETF NEW	D 25459W110	1,500.00	02/17/12	02/17/12	\$ 27,219.14	\$ 27,505.68	\$ 286.54	\$ 0.00
DIREXION SHS ETF NEW	D 25459W110	2,500.00	02/17/12	02/17/12	\$ 45,692.73	\$ 45,843.26	\$ 172.29	\$ 21.76
DIREXION SHS ETF NEW	D 25459W110	3,000.00	02/17/12	02/17/12	\$ 54,740.06	\$ 55,218.46	\$ 478.40	\$ 0.00

**Why it matters:** Is the 1099-B reporting correct or in error? Unexplainable anomalies call into question the accuracy and reliability of 1099-B reporting. Increased tax reporting burden also results when taxpayers must spend extra time and effort attempting to verify the accuracy of their 1099-B reporting.

## SECTION 3: FLAWS AND CHALLENGES IN REPORTING REQUIREMENTS

Cost basis legislation and the subsequent IRS reporting requirements had the intention of reducing taxpayer reporting burden while also closing the tax gap in misreported capital gains and losses. Do the results achieve these intentions?

Thus far we have examined some of the real problems that exist with 1099-B reporting. Now we will focus on flaws that exist in the reporting requirements which betray the intentions of the legislation.

### *1099-B Reporting is Unverifiable Accounting Information*

A vital principle in accounting is the importance of having verifiable information. 1099-B reporting fails to meet this principal. How so? Consider the example shown in Figure 3.1 below.

**Figure 3.1**

Proceeds from Broker Transactions — 2012 (continued)		From Broker 1099-B Statement			Form 1099-B		
Department of the Treasury-Internal Revenue Service				Copy B for Recipient (OMB No. 1545-0715)			
1c-Type of gain or loss: Short-term (Report on Form 8949, Part I, with <b>Box A</b> checked.)				SHORT-TERM HOLDING PERIOD			
6b-Basis reported to IRS				COST BASIS IN THIS SECTION IS REPORTED TO THE IRS			
8-Description	CUSIP Number 1g-Stock or other symbol	**	1b-Date of acquisition 1a-Date of sale or exchange	2a-Sales price of stocks, bonds, etc. (less commissions and options premiums) 1e-Quantity sold	3-Cost or other basis	5-Wash sale loss disallowed	4-Federal income tax withheld
NVIDIA CORP	87086G104	\$	10/23/12	\$ 13,586.26	\$ 13,810.94	\$ 24.68	\$ 0.00
	NVDA		10/23/12	1,100.00			
NVIDIA CORP	87086G104	\$	10/23/12	\$ 17,290.20	\$ 17,323.01	\$ 32.81	\$ 0.00
	NVDA		10/23/12	1,400.00			
NVIDIA CORP	87086G104	\$	10/24/12	\$ 24,570.50	\$ 24,453.67	\$ 36.14	\$ 0.00
	NVDA		10/25/12	2,000.00			
NVIDIA CORP	87086G104	\$		\$ 48,989.95	\$ 48,970.78	\$ 62.09	\$ 0.00
	NVDA		10/26/12	4,000.00			
NVIDIA CORP	87086G104	\$		\$ 48,829.98	\$ 48,751.04	\$ 7.86	\$ 0.00
	NVDA		11/01/12	4,000.00			
NVIDIA CORP	87086G104	\$	11/04/12	\$ 2,415.95	\$ 2,380.09	\$ 0.00	\$ 0.00
	NVDA		11/13/12	200.00			
NVIDIA CORP	87086G104	\$	11/04/12	\$ 6,038.97	\$ 5,950.22	\$ 0.00	\$ 0.00
	NVDA		11/13/12	500.00			
NVIDIA CORP	87086G104	\$		\$ 5,024.54	\$ 4,983.68	\$ 0.00	\$ 0.00
	NVDA		11/26/12	418.00			
NVIDIA CORP	87086G104	\$		\$ 31,230.91	\$ 30,660.47	\$ 0.00	\$ 0.00
	NVDA		11/26/12	2,584.00			
NVIDIA CORP	87086G104	\$	12/03/12	\$ 1,194.07	\$ 1,178.90	\$ 0.00	\$ 0.00
	NVDA		12/04/12	100.00			

In this example the broker is reporting information for NVIDIA Corporation, ticker NVDA. Note a few points:

1. If a purchase of shares triggered a wash sale, then the cost basis has been adjusted based on the allocated amount of the respective disallowed loss. Looking at the information provided can you determine what cost basis adjustments have been made, the reason for the adjustments and the amount? For that matter, what was the original cost basis?



*The 1099-B  
fails to meet  
the accounting  
principles  
for verifiable  
and objective  
reporting.*

2. If a purchase of shares triggered a wash sale, the holding period of those shares is adjusted to include the holding period of the shares that were sold at a loss. The broker has therefore adjusted the acquisition date to represent that new holding period. Therefore, the dates shown for some trades do not actually represent the date the trade occurred. Once again, can you determine why the date was changed and which wash sale was included in the holding period adjustment?
3. If the taxpayer must make additional wash sale adjustments based on taxpayer reporting requirements (see section 1 of this report), they will need to identify purchases of shares that have not been adjusted for wash sales. Those purchases may have potentially triggered a wash sale in another account or in a substantially identical security. Looking at the trades on this example, can you identify those purchases and the date they were acquired? You will note that some trades do not even include a date acquired because the broker is allowed to group together shares that were acquired on different days but sold in the same lot (as is the case with the shares sold on 11/1/2012).
4. You will also note that there is \$7.66 reported as a wash sale loss disallowed on 11/1/2012. When you subtract the cost basis from the sale proceeds you'll see there was a net gain of \$78.92. How can there be a disallowed wash sale loss on a trade that reports a net gain?

In this example, the 1099-B does not tell us how many shares the \$7.66 disallowed loss represents. The only way this can be determined is to use the supplemental Realized Gain & Loss reporting, which this broker happens to provide. There we were able to identify that this single trade actually represents shares purchased on three separate days and at three different costs. The 1099-B instructions allow a broker to report all of these in one lot, but notice the extra work now involved trying to verify the reporting?

**From an accounting standpoint the 1099-B is not verifiable or objective.**

The information reported has been adjusted based on rules that only apply to brokers and the report does not provide factual details which explain the adjustments made. The extreme work involved in trying to verify and reconcile the 1099-B reporting with a taxpayer's own records has increased the reporting burden on taxpayers and failed to fulfill the intentions of the legislation.

## *Form 8949 Requirements Increase Taxpayer Reporting Burden*

The IRS instructions for Form 8949 provide the following idealistic purpose to this form on page 1:

“Use Form 8949 to report sales and exchanges of capital assets. Form 8949 allows you and the IRS to reconcile amounts that were reported to you and the IRS on Form 1099-B or 1099-S (or substitute statement) with the amounts you report on your return. If you received Form 1099-B or 1099-S (or substitute statement), always report the proceeds (sales price) shown on that form (or statement) in column (d) of Form 8949. If Form 1099-B (or substitute statement) shows that the cost or other basis was reported to the IRS, always report the basis shown on that form (or statement) in column (e). If any correction or adjustment to these amounts is needed, make it in column (g). See How To Complete Form 8949, Columns (f) and (g), later, for details about these adjustments.”

The concept sounds ideal: Take the information from the 1099-B and use it to complete the 8949. Taxpayer reporting should be so easy! Except there is that phrase “If any correction or adjustment to these amounts is needed, make it in column (g).” Now that we’ve established the fact that the 1099-B does not have to report all necessary adjustments for taxpayers, this means that the taxpayer must verify everything reported on their 1099-B. When something is incomplete or requires an additional adjustment then they must make those adjustments.

Later on page 1 of those instructions the IRS provides the appropriate reminder that the taxpayer *“must keep accurate records that show the basis and, if applicable, adjusted basis of your property.”* So in theory the taxpayer can use their own records to verify the 1099-B and make any adjustments. But there is one problem: as we have highlighted the 1099-B does not provide sufficient verifiable information. We have seen taxpayers, tax preparers, even CPAs who have spent hours, even days, trying to interpret and understand how and why the broker made certain adjustments so that they can verify – and most times they give up because of the complexity.

We agree that broker reporting on 1099-B should be reconciled with taxpayer reporting, but when there are two sets of rules for brokers and taxpayers and when the broker reporting does not provide verifiable data, the IRS is asking taxpayers to make apples look like oranges.

***An impossible task: Taxpayers are expected to use flawed 1099-B reporting to complete Form 8949 – following different sets of rules.***

*The information and instructions provided by the IRS are misleading and confusing.*

## *Misleading Information*

Taxpayers have been provided with misleading information regarding the tax reporting requirements which only exacerbates the challenges they face. Let's examine some statements:

“You must keep accurate records that show the basis and, if applicable, adjusted basis of your property. Your records should show the purchase price, including commissions; increases to basis, such as the cost of improvements; and decreases to basis, such as depreciation, nondividend distributions on stock, and stock splits.” – IRS Instructions for Form 8949, 2012, page 1.

Here the IRS recognizes that taxpayers need to keep their own records for their trading history, including records of all adjustments affecting cost basis. We agree that this is vital. However, we find that many taxpayers do not keep these records because “my broker provides that information on the 1099-B”. And they then point to other statements by the IRS such as:

“If you sold property, such as stocks, bonds, or certain commodities, through a broker, you should receive Form 1099-B or substitute statement from the broker. Use the Form 1099-B or substitute statement to complete Form 8949.” – IRS Publication 550, 2012, page 68

This seems to give authority to the fact that the 1099-B is accurate and can be used for reporting trading activity. Except then the taxpayer looks closely at the 1099-B reporting they receive and they see a statement like:

“You will continue to be responsible for reporting all cost basis information for both covered and uncovered securities to the IRS on your tax returns.” – From a broker provided 1099 Composite Statement or “Remember, taxpayers are ultimately responsible for the accuracy of their tax returns.” – From a broker provided 1099-B Statement.

So the brokers rightly disclaim the fact that they are not responsible for taxpayer reporting. Which then increases accountability for the taxpayer to verify what the broker is reporting. This is reiterated by the IRS statement regarding wash sales:

“However, you cannot deduct a loss from a wash sale even if it is not reported on Form 1099-B (or substitute statement).” – IRS Publication 550, 2012, page 60.

Which begs the question: are there wash sales that are not reported on the 1099-B? Of course, we have already highlighted in this report the fact that brokers are exempt from identifying and reporting many of the potential wash sale situations. So it is very likely that many traders and investors have additional wash sales not reported on 1099-B. Sadly this fact is not even mentioned in the instructions for Form 8949. Actually the 8949 instructions can be more misleading when they state regarding reporting adjustments to gain or loss in columns (f) and (g) on Form 8949:

“For most transactions, you do not need to complete columns (f) and (g) and can leave them blank.” – IRS Instructions for Form 8949, 2012, page 5.

This statement would make you think that those columns are rarely needed. However, all wash sales, those identified by the broker as well as those not identified on the 1099-B, must be reported in columns (f) and (g) of Form 8949.

For 2012 the IRS added the option for taxpayers to use a substitute statement instead of Form 8949. Unfortunately the instructions for this option also are misleading, one part states:

“For example, report on Part I with box A checked all short-term gains and losses from transactions your broker reported to you on a statement showing that the basis of the asset sold was reported to the IRS.” – IRS Instructions for Form 8949, 2012, page 2.

So does this mean that if the statement shows reported cost basis it is ok to use it? It does not matter whether the statement has been verified and all wash sales adjusted? Some brokers have even gone out on a limb to provide “8949 Worksheets” to help clients complete the 8949. Presumably these could simply be used as substitute statements in the IRS provision.

One major broker provides a very official looking 8949 Worksheet that is formatted very much like the IRS form. We have heard many taxpayers state ‘my broker has generated my 8949 for me’. They don’t take note of the specific statement at the bottom of the worksheet which states it “is not intended to constitute tax advice which may be relied upon...” While their intention was good, such worksheets have misled many taxpayers.

*One might wonder  
if anyone at the  
IRS has ever  
actually completed  
the tax reporting  
required for an  
active trader?*

Also misleading are statements often made about e-filing. For example, TurboTax® a leading tax software, states:

“TurboTax Online's import feature lets you import tax information from these financial sources:

- Forms 1098, 1099-B, 1099-DIV, 1099-INT, 1099-MISC, 1099-OID and 1099-R from participating banks, brokerages, and mutual fund companies”
- From [www.turbotax.intuit.com/tax-answers/](http://www.turbotax.intuit.com/tax-answers/)

Many taxpayers believe that they can simply import their 1099-B into programs like TurboTax® and that is all they need to do. But this can be misleading. First of all we have not found a broker that actually transmits the 1099-B data to TurboTax®. When we asked a representative at one major broker about this they advised us that the information imported into TurboTax® is technically not the 1099-B but is the Realized Gain and Loss reporting that the broker generates. While that information should contain the same data reported on 1099-B, it may also contain additional information such as securities not reported on the 1099-B. This has been confusing to some taxpayers.

More importantly though is what is done with the information imported from a brokerage firm to many popular programs like TurboTax®. What we have found is that most popular tax software programs do nothing more than fill in the Form 8949 with the broker reported information. There is no verification process, nor are there any additional adjustments made for wash sales not reported by the broker. Taxpayers are responsible for identifying and manually entering these into the tax software program. Many taxpayers are unaware that the information they imported may not be accurate for tax purposes.

It is evident from this brief review of instructions and statements how easily taxpayers can be misled and confused. The general notion is that they can use the 1099-B for tax reporting. Yet, the fine print places the burden of accuracy on the taxpayer, and the actual IRS requirements direct taxpayers to make additional adjustments for wash sales and other needed adjustments.

Taxpayers who seek to file accurate tax returns must do extra work to try to meet IRS requirements. Of course, our human nature is to take the course of least resistance, so it is easy to understand that most traders and investors simply rely on whatever the broker sends them. This makes you wonder then, how well is this legislation closing the tax gap?

*The IRS has made it easier to file inaccurate and erroneous tax reporting.*

## *The Tax Gap Result*

Let's be honest, the biggest concern of congress and the IRS is collecting taxes that are not being paid. One of the motivating factors behind cost basis legislation was the evidence that traders in securities represented a large chunk of the tax gap – taxes that are not paid. Some taxpayers intentionally do not report correct information in order to decrease their tax liability. Other taxpayers simply do not have the information they need in order to file accurately. So what has the 1099-B and Form 8949 requirements accomplished?

We agree wholeheartedly that brokers should provide more than just sale proceeds on a 1099-B. For many years traders would struggle with obtaining the cost basis for securities. Requiring brokers to report cost basis is essential, but why does the IRS require adjusted cost basis, specifically adjustments for wash sales? Because the wash sale rule was designed to prevent a trader or investor from inflating their losses and in turn reducing taxable gains.

### ***An example of why the wash sale rule is important:***

A trader has \$5,000 in short term taxable gains for the year. Realizing this, he decides to reduce those gains by selling a security he's owned at a huge loss, let's say (\$6,000). This now offsets his gain so that he has a net loss of (\$1,000) for the year. Then he buys back the same shares he sold on the next day. Since the price of those shares likely has not changed much, he is probably able to buy them back at a cost relatively close to what he sold them for and, therefore, he really did not have a loss. What he has managed to do is get out of paying taxes on the money he made this year!

This is why the wash sale rule comes into play. The wash sale rule says that the (\$6,000) loss is disallowed. The 'replacement' shares purchased the following day are adjusted, the amount of \$6,000 is added to the cost basis, and the holding period now includes the period of the original shares. This is a simple example, but there are many complex aspects of the wash sale rule to address many other wash sale situations.

The wash sale rule is vital to preventing taxpayer fraud. But enforcing those rules has been ever challenging. Thus, in drafting the cost basis legislation congress thought it would be a good idea for brokers to identify wash sales and make the appropriate adjustments. A broker faces many limitations, such as the inability to know trade activity in other brokerage accounts. Therefore, brokers were exempted from adjusting for all possible wash sales, as highlighted earlier in this report.

*The ultimate goal of the new 1099-B reporting was to help close the tax gap from traders and investors who incorrectly report capital gains taxes.*

*The IRS has designed a system which makes tax evasion easier by generating wash sales not reported on 1099-B.*

What is accomplished by having limited wash sale reporting on 1099-B? No doubt many more wash sales have been identified and reported by taxpayers. But does the 1099-B prevent the intentional use of wash sales by taxpayers trying to reduce their taxable gains? We would say 'no'. In fact, it can be argued that the new 1099-B and Form 8949 reporting allows unscrupulous taxpayers to more successfully evade the wash sale rules. Why do we say this?

Many active traders maintain more than one brokerage account, either with the same broker or with different brokers. Online trading makes it easier than ever for traders to buy and sell quickly in multiple accounts. A trader can easily sell a security at a loss in one account while repurchasing in a different account, even simultaneously. While the IRS states this is still a wash sale and is thus disallowed, it will never be reported on the 1099-B. If the taxpayer simply uses the 1099-B reporting for Form 8949, failing to make the additional wash sale adjustments required, will the IRS ever know? Likely not, because the 1099-B and 8949 will reconcile perfectly! A full IRS audit would be needed in order to identify these additional wash sales by the IRS.

So in reality, the IRS has designed a system which makes wash sales easier to use by those trying to evade the tax rules. In addition, the overwhelming complexity and challenges involved in filing Form 8949 handicaps those taxpayers who desire to accurately report their taxes.

**While the intentions of cost basis legislation were good, the resulting regulations are seriously flawed.**



## SECTION 4: HOW TO DO IT RIGHT

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### *Changes Needed for Accurate Capital Gain and Loss Reporting*

As this report has highlighted, the current IRS requirements for 1099-B reporting and for Form 8949 are problematic and do not help taxpayers to report capital gains and losses accurately. Taxpayers have been misled to think that the 1099-B has all the information they need for tax reporting. Many brokers and popular tax filing programs have not helped clients to understand what is required for accurate filing.

Thousands of active traders and investors have turned to solutions like TradeLog software to help create accurate tax reporting. TradeLog software has been generating tax reports with wash sale adjustments for over a decade. The publishers of TradeLog found out early on that the only way to generate accurate tax reporting is to rely on accurate and verifiable trade history data. Broker provided P&L or gains and loss reporting is usually subjective or inaccurate. Using actual trade history TradeLog is able to generate capital gain and loss reporting that is accurate based on IRS rules outlined in publication 550, including all wash sale adjustments.

Even with programs like TradeLog available, challenges remain. For example, reconciling taxpayer reporting with the 1099-B is extremely difficult because of the differing rules and the errors we have mentioned. In addition, the specific rules for Form 8949 have increased the reporting burden for taxpayers who desire to file accurate tax reporting. Therefore, we believe more must be done to change the burden that has been placed on taxpayers and to achieve the intended results of cost basis legislation.

We believe congress and the IRS need to revisit the current legislation and requirements in order to get it right. TradeLog has been generating tax reporting for traders and investors for over twelve years. We understand what is needed for accurate wash sale adjustments. Following are key recommendations we would make:

***Congress and the IRS need to revisit current legislation and requirements in order to get it right!***

**1099-B reports should provide accurate and verifiable trade history information.**

## *Brokers and 1099-B*

Brokerage firms have been put in a terribly awkward position with the current legislation. In effect, they are being asked to do tax accounting to a limited degree by providing adjusted cost basis information and wash sale reporting. Because there are limitations to what a broker can adjust and report, their results are often inadequate. We believe that brokers should only be required to report verifiable information based on actual trade transactions they executed for their clients. Specifically:

1. Brokers should be required to report actual trade history on the 1099-B. This would include the actual cost basis and proceeds for each matched trade that is considered closed in the tax year. This is the information that taxpayers need in order to generate their tax reporting.
2. Brokers should be required to report a flag if a client sold a security and then bought more shares of the same security within 30 days in the same account. This flag would indicate "possible wash sales". Notice that the broker would not be identifying and adjusting those wash sales – this would be the requirement of the taxpayer. The brokers' flagging possible wash sales simply alerts the taxpayer and also provides the IRS with the indication that this taxpayer should likely report wash sales on Form 8949 – this could be a trigger used by the IRS on determining whether a tax return should be reviewed.
3. Brokers should be required to report all securities by industry standard ticker symbols as of the date of the trade, for easy reconciliation. This standardized information allows taxpayers to more easily identify wash sales.
4. Brokers should be required to report all corporate actions that effected securities owned by the client in the course of the tax year. Making adjustments for such corporate actions should be the responsibility of the taxpayer, however, the broker should provide the information the taxpayer needs such as the date of the action and the specific terms.
5. Brokers should be required to provide a 1099-B report for trades in a non-taxable IRA account, indicating the trades are "non-taxable". This provides the information needed by the IRS and taxpayer for adjusting wash sales that occurred as a result of IRA trades.
6. Brokers should be required to provide all 1099-B reporting in an industry standardized digital format which can be utilized by taxpayers and third-party tax software (csv, txt, or similar format). We live in a digital age where most taxpayers are using software

programs. The IRS states that e-filing is now "the norm" ([www.irs.gov/Filing](http://www.irs.gov/Filing)). The fact that the brokers only provide the 1099-B in printed form or PDF is antiquated.

### *Taxpayers and Form 8949*

The IRS has always held taxpayers accountable for accurate tax reporting and rightly so. We believe that taxpayers should be provided with the information they need on 1099-B and be required to use this in completing Form 8949. Specifically:

7. Taxpayers should be required to report all trade activity from the 1099-B(s) on Form 8949 and then make additional adjustments for wash sales and other tax rules. They may choose to complete this themselves, use a third-party software solutions, or professional tax preparer.
8. The taxpayer's Form 8949 should reconcile with the 1099-B, total unadjusted cost basis and sale proceeds should match. The exception would be any securities not reported on Form 1099-B.

### *Internal Revenue Service*

We believe one of the main reasons traders in securities do not file accurate capital gains reporting is because of the persistent ambiguity and confusion over many of the IRS regulations. In order to reduce the taxpayer burden and close the tax gap it is essential that the IRS also does their part in providing clear guidance and enforcement. Specifically:

9. The IRS should be required to clarify wash sale reporting rules. There are numerous questions that have remained unanswered for decades regarding vague points in the IRS rules. For example: how exactly should the taxpayer account for the adjustment to holding period, by changing dates on their reporting or by some other method? If replacement shares were purchased on more than one date within the wash sale window, which trade should be adjusted for the wash sale? The IRS should address all questions regarding wash sales and taxpayers and tax professionals should have a channel for seeking reliable guidance on situations they may have.
10. The IRS must enforce 1099-B reporting deadlines. Currently brokers are required to provide 1099-B reporting to their clients by February 15. However, many brokers have failed to meet this deadline. The National Association of Tax Professionals commented on April 1, 2013 "the habitual practice on the part of the IRS to extend the

***The IRS should clarify the many vague aspects of the wash sale rules.***

*With accurate  
trade history  
information  
taxpayers can  
generate the  
needed tax  
reporting with  
reduced burden.*

due date for Form 1099-B for clearing houses is extraordinarily problematic." We agree with this comment and recommend the IRS enforce reporting deadlines.

11. The IRS should also be required to outline reporting requirements for taxpayers in a realistic and timely manner. For example, for 2012 tax year the final Form 8949 was not released until early January 2013. The Form 8949 Instructions were not released until January 20, 2013 (although dated January 17, 2013). This is a consistent problem with many IRS forms and publications that are needed by taxpayers. We recommend that the IRS be required to also maintain a reasonable deadline for providing guidance and forms. Ideally, we believe that reporting requirements should be dictated before a tax year begins as this allows taxpayers to maintain proper records throughout the tax year.

It is our opinion that these recommendations would accomplish the intent of the cost basis legislation. By providing taxpayers with accurate information and clear guidance they are able to report capital gains and losses correctly. Taxpayers have the freedom to choose how they generate their reporting, be it manually completing IRS provided forms, utilizing a tax professional, or using a third party software tool. While the accountability for accurate reporting is still on the taxpayer, they have the tools needed to do so within a reasonable burden. In addition, the IRS will have information that can be used for verification and enforcement.

## CONCLUSION

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As we have shown, the 1099-B reporting requirements are a major problem. Brokers continue to struggle to produce correct 1099-B reporting, and to do so on time. Taxpayers are faced with the choice of either filing accurate tax reporting – which often involves an extreme reporting burden – or that of simply using the 1099-B reporting as-is even though it may not be accurate, and hoping they don't get reviewed or audited. The federal government, while hoping to close the tax gap and enforce wash sale reporting, has left open a major hole in reporting requirements which could allow traders in securities to evade taxes by generating wash sales which would never be identified on 1099-B.

We have also shown that there are major problems in the instructions that the IRS is communicating to taxpayers and brokers. They maintain two sets of wash sale reporting rules, one for brokers and one for taxpayers. While holding taxpayers accountable for accurate tax reporting, they also direct them to use un-verifiable reporting provided on 1099-B. This results in unnecessary burden on taxpayers who desire to file accurate taxes.

We believe that this situation can be remedied. Congress had good intentions in overhauling broker reporting. Unfortunately, the end result simply missed the mark. Are the current regulations and requirements simply the best possible solution? Based on the facts and our experience we can state the answer is no.

The current regulations and requirements do not provide the best solution. Traders and investors need accurate and verifiable trade history which can then be used to generate tax reporting with needed wash sale reporting. Wash sale adjustments, or any other non-verifiable adjustments, do not belong on the 1099-B. As long as the IRS continues to maintain the current direction for 1099-B and Form 8949 reporting the problems we have highlighted will not improve.

Is there a better way to provide taxpayers with the information they need for accurately reporting capital gains and losses? With standardized trade history reporting and clear guidance from the IRS, as stated in our recommendations, taxpayers will have the information they need for accurate tax reporting. In addition, the IRS will have verifiable information which can be used for reconciliation and enforcement purposes.

We believe that the goals of cost basis legislation can be met only if the Internal Revenue Service pursues a change of course in 1099-B regulations. While we continue to support active traders and investors in providing the most accurate reporting that is reasonably possible for Schedule D and Form 8949 – we hope that this report will help draw attention to the serious problems faced and facilitate the action needed for change.

***While current IRS requirements for 1099-B reporting fails, it is possible to fix the situation and achieve the original goals of cost basis legislation.***