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Securities reporting rule could make for some insecure advisers

Ramped-up role in spelling out tax implications of stock sales might well be 'differentiator' in landing prospects; boon to some, bane to others

By Lavonne Kuykendall
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New IRS rules will put pressure on financial advisers and accountants to manage the tax consequences of a client's decision to sell stocks.

The rule — which goes into effect in 2011 for corporate stock, in 2012 for mutual funds and some dividend reinvestment programs, and in 2013 for all other securities — is part of the Emergency Economic Stabilization Act of 2008. It changes the way custodians must report securities sales to the IRS and investors. Rather than report only the sale price of a security, as in the past, custodians now must report both the purchase and sales price, minus commissions and fees. The IRS estimates this will help it collect an additional $6.6 billion in taxes over ten years.

Investors have always been required to report the so-called cost basis, or net purchase price for the securities they sell, but they were responsible for gathering purchase information themselves. This frequently left their advisers or accountants in the dark.

Now that it will be more readily available, advisers will have the information they need to minimize capital gains, perhaps by specifying a particular lot of shares to sell, said long-time tax attorney Stan Smiley, senior vice president of the advanced planning group at Cetera Financial Group,

"The role of the adviser will become more important in working with the client to minimize taxes," Mr. Smiley said. "It is an opportunity to enhance the relationship."

The usual way of handling stock sales has been the so-called “first in, first out” method, which assumed that a partial sale of shares came from the earliest purchase. In a rising stock market, that almost always will result in the highest possible tax. Investors don't frequently take advantage of the option to choose a particular lot to sell, or to sell the last lot they purchased, both of which are allowed, Mr. Smiley said.

The tax consequences can be huge. Shares bought years ago for a fraction of the current price could net a big capital gains tax, he noted, while shares bought one year ago at a bit below the selling price could result in a minimal tax bill.

The rule covers only securities bought after the rollout of the new regulations, so it will take time before advisers can take full advantage of the new information.

Still, Mr. Smiley noted that many investors don't have a firm understanding of their options for calculating cost basis. Advisers who understand and use the new information may find it's "a differentiator when meeting with prospective clients," he said.