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Tips for Solving the Cost-Basis Mystery

By Arden Dale – JUNE 20, 2011

That old gift of stock from a parent or Uncle Jerry can create a tax headache when the time comes to sell it.

Capital-gains tax due when someone sells a gift of stock is generally based on what the original owner paid for the shares, as well as events such as mergers, spinoffs and stock splits that occurred at the company in the years since (the calculation is a little different if the stock is sold at a loss). That original basis, though, is often lost in the mists of time.

Every tax adviser has a war story about how hard it can be to track down basis from a gift, especially if the shares were purchased a long time ago or issued by a company with a tangled corporate lineage. It is up to the owner of the stock to keep track now, but brokers will have to start reporting basis on Internal Revenue Service Form 1099-B next year.

Inherited shares don't cause such angst; in these cases, basis is based on the value of the stock at the time the person who bequeathed it died. A taxpayer or adviser can find that on an estate tax return or research what the stock was worth on that date. Starting next year, brokers generally will be required to determine the value of the stock on the date of death if the estate doesn't provide it, and report the value on Form 1099-B.

Good Detective Work

To solve a cost-basis mystery for a gift of stock, start by going back to the family archives and looking for the original investment statements. Anyone who comes from a long line of pack rats may have an advantage.

Without access to the original paperwork, however, “you can really be hard-pressed” to find the information you need, says James H. Guarino, a partner at Boston-area accounting and consulting firm MFA - Moody, Famiglietti & Andronico LLP.

Adam R. Gorlovsky-Schepp, a certified public accountant at Boston-based Raphael and Raphael LLP, suggests heading to the local library for clues. Grab a Wall Street Journal from the year shown on the stock certificate and find the old stock symbol for the company, he says.

The original price of the shares is just one piece of the puzzle. Mergers or spinoffs that caused stock splits have to be taken into account, too. Aunt Sadie may have paid \$10 for a share of Acme Inc. way back when, but its basis will be one-fifth of that after a five-for-one stock split leaves her with five shares for her initial one, explains Stevie Conlon, senior director and tax counsel at Wolters Kluwer Financial Services. AT&T stock presents the king of all cost-basis riddles with the complicated history of the telephone company and its “Baby Bells,” the seven regional companies broken off from the old AT&T in 1984.

To find a corporate genealogical tree that lists events that affect cost basis, look on the Internet. Some companies even have cost-basis calculators on their websites as part of their shareholder services.

Many CPA firms also use software programs to help them calculate adjusted basis. In preparing tax returns

for clients, firms typically will research changes to basis “and not charge, so you may not even know,” says Melissa Labant, of the American Institute of CPAs.

These programs can be excellent, providing the entire history of a security and breaking out how basis was adjusted each time a merger or other event occurred, she says.

No matter how you get there, create a paper trail in case the IRS questions a tax return.

This Could Keep

A copy of the check used to buy the shares, or an original bank statement showing the amount paid for the shares, could help in those cases. A stock certificate is good to have but doesn’t show what the owner paid for the shares.

The IRS hasn’t challenged many of his clients on cost basis, says Mr. Guarino. That may change once brokers have to start reporting it. Then, the IRS can easily match basis reported on a Form 1099-B with that shown on a tax return.

The lesson for anyone thinking about making a gift of stock: Give cost-basis information along with it.

Without it, recipients could end up with a lot of detective work to do and a big tax bill if the trail runs cold, especially if they err on the side of caution and pay what they estimate the biggest likely tax bill would be.