Looking Out for Your Client's 1099

How the responsibility of reporting gains and losses is falling more onto brokers.

BY ROBERT GORDON

For years, brokers reported when a client sold a stock, but weren't required to report whether the investment had a gain or a loss.

That makes the form 1099 a good starting point for advisors to help spot last-minute tax filing issues that can impact clients, now that brokers have to include these cost basis gains and losses. The government wants to know the outcomes of investments clients made during the year.

For example, this tax season was particularly vexing with option reporting being phased in as of Jan. 1, 2014. There are different tax regimes for options that trade on an exchange and options that trade over the counter. All exchange-traded options on single stocks and almost all OTC options (on anything) are taxed normally, if held for less than one year and treated as short term, or held for more than one year and treated as long term.

However, exchange-traded options on anything other than an equity are taxed under Section 1256 as being 60% long term and 40% short term whether the options are held long or sold short, and no matter how long they are held. Additionally, these options are marked-to-market at every year end. You may recognize this as the tax treatment offered to exchange-traded futures. Indeed, it was the introduction of S&P 500 index options that spawned this unique option tax treatment.

Identifying Tax Treatments

The problem is the brokers didn't want to try to identify which options should get what tax treatment. Many ETFs are not equities: They can be partnerships, grantor trusts or take on other foms. For example, SPDR Gold Shares is a grantor trust holding gold. However, the brokers are not reporting options on GLD as an option that should get Section 1256 treatment. An investor who bought an exchange-traded option on GLD and held it over yearend will see nothing in their 1099 about that holding.

Brokers' Best Shot

The form should have marked the position to market at year end with the resulting gain or loss being reported as 60% long term and 40% short term.

Instead, the taxpayer will need to attach a note onto his return to explain the situation and do the taxes properly. This will be the case for exchange-traded options on MLPs, many ETFs and other broad-based indexes like the S&P.

You might empathize with the broker's dilemma of divining which is which when you recognize that an exchange-traded option on the S&P 500 ETF [which is an equity] is taxed normally and an exchange-traded option on the S&P 500 index is taxed as a Section 1256 contract.

Brokers have been told to give it their best shot but are expressly forgiven if the information is incorrect. If they can't be expected to figure it out, then how are clients supposed to? OWS

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