CELENT

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Cost Basis Reporting: Additional Revenue for Tax Professionals?

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Introduction

In October 2008, the Emergency Economic Stabilization Act was passed, mandating new requirements for cost basis reporting. Title IV, Section 403 requires that financial intermediaries report adjusted cost basis information for covered securities to the Internal Revenue Service (IRS) and to taxpayers. The legislation phased in the required reporting of securities over a period of three years.

We have now passed Phase II of the requirements, and brokers should be currently tracking adjusted cost basis for stocks acquired after January 1, 2011, and for mutual funds and dividend reinvestment plans (DRiPs) acquired after January 1, 2012.

As the deadline for filing 2011 Federal taxes approaches, there has been a flurry of activity from brokers, retail investors, and tax accountants. As of February 15, brokers were required, for the first time, to send out Form 1099-Bs with adjusted cost basis information on stocks acquired after January 1, 2011 to their customers and to the IRS. Retail investors and their accountants are now scrambling to accurately report their capital gains/losses while using the new 1099-Bs. These retail investors are finding, however, that this is not an easy task. New Schedule D forms and Form 8949s are increasing the reporting burden for retail investors. Furthermore, investors are finding various discrepancies between their tax forms and the 1099-Bs sent by the brokers. These discrepancies can be attributed to differing reporting requirements between brokers and retail investors, and will be explored thoroughly in the paper.

During the past month, Celent conducted interviews with financial intermediaries, technology providers, and tax accounting/preparation firms to understand current challenges from a retail investor perspective as they relate to cost basis reporting. This report will focus on what these new cost basis requirements mean for the retail investor and explore the challenges that they may face. Additionally, this report will posit that these cost basis reporting challenges provide opportunities for CFPs, CPAs, tax preparers, enroll agents, wealth managers, and estate attorneys to extend their services and aid retail investors. Celent will discuss these opportunities and outline the revenue gains for these services.

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Challenges for Cost Basis Reporting

Since 2008, industry analysis has focused on the challenges brokers have faced as it relates to complying with cost basis reporting regulations. However, little attention has been paid to how these regulations have affected retail investors. These regulations have not only created new tasks and tax forms for the retail investor, but have also created disparate reporting requirements between investors and their brokers.

This section will elucidate how the different reporting requirements between retail investors and brokers have created substantial challenges for the investor.

Disparate Reporting Requirements Between Brokers and Investors Creates Challenges

The new cost basis reporting regulations require collaboration between retail investors and brokers. In order for retail investors to complete what is now required of them in the new cost basis reporting regulations, they must rely on brokers supplying accurate information on the 1099-Bs.

However, retail investors are experiencing significant challenges related to taking 1099-B information and reporting cost basis information to the IRS via a reformatted Schedule D and a new form entitled "Form 8949, Sales and Other Dispositions of Capital Assets." While some of this may be due to the complexity of the forms themselves (see Figure 4 in the Appendix for a snapshot of the Form 8949), retail investors are finding that they cannot reconcile the information on broker-provided 1099-Bs with their own Schedule D and 8949 calculations. The primary reason for retail investor challenges in filling out their Form 8949s is a fundamental lack of harmonization between what is required of the broker and what is required of the investor. Celent has outlined several of the differences between what is required of the brokers and what is required of the investor:

Brokers are required to track cost basis information only for "covered" securities. Brokers are required to provide adjusted cost basis information for equities purchased after January 1, 2011, for mutual funds purchased after January 1, 2012, and for options and bonds purchased after January 1, 2013. As a result, investors will not receive cost basis information from their broker on securities purchased prior to each asset class' respective phase-in date. However, investors are still responsible for accurate reporting of cost basis for the entire holding period, regardless of how far back the purchase was made. This January 1, 2011 starting date for calculating cost basis on "covered" equities has also created issues tracking wash sales for this year. If a retail investor buys and sells ABC stock on December 28, 2010 for a loss, and then buys that stock again on January 7, 2011, this is a wash sale. However, the regulations mandated that brokers begin tracking wash sales for stock on January 1, 2011. Thus only the purchase on January 7, 2011 would be recorded; the wash sale deferral is left out and not included on the 1099- B.

Brokers have different reporting rules around gifted and inherited securities. For gifted securities, the broker needs only to provide fair market value. For the investor, however, there are a series of complex considerations in order to compute the cost basis of a gifted security, such as whether the fair market value is greater or lesser than the donor's cost basis on the gift date. If the fair market value is greater than the donor's cost basis, the basis of the recipient's gift may not be determinable until the date of sale. The cost basis of shares acquired after the death of an individual are generally the value of the shares on the date of the donor's death. This valuation must also reflect any corporate actions between the date of death and the transfer of shares to the recipient. However, in the case of reporting inheritance-related transfers, the broker does not need to contact the estate representatives to obtain values as of date of death, but needs only to compute the fair market value of the securities to the extent that they are readily ascertainable. Without inquiring as to the value of the shares as of the date of death, brokers may calculate fair market value information that is not the correct basis.

Brokers need to calculate and report only on "identical positions," whereas retail investors are required to calculate wash sales between "substantially identical positions." The IRS mandates that brokers calculate and report wash sales on positions with the same symbol only. However, retail investors must calculate and report wash sales on positions that account for "substantially identical" securities and positions. This can include new and old securities issued by a corporation that has reorganized and also positions between stocks and options.

Brokers are not required to track and report cross-account wash sales. Brokers are required only to track and report a wash sale in the same account with the same CUSIP. However, retail investors often have more than one investment account and are mandated to report on wash sales across all their holdings and accounts. This means that if an investor buys and sells ABC stock on January 5, 2011 with "Broker

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A" and then buys ABC stock on January 19 with "Broker B," he has triggered a wash sale. When filling out his Schedule D and Form 8949, he must report this wash sale. However, "Broker A" cannot know what transactions the investor has completed with "Broker B" and vice versa. Therefore, Broker A is responsible only for tracking the buy and sell of ABC stock on January 5, and Broker B is responsible only for tracking buy order of ABC stock on January 19. Thus, neither broker is responsible for reporting this wash sale on their 1099-Bs. Even if the same set of transactions occurred (buy/sell on January 5 and then buy on January 19) at "Broker A" but within separate accounts (for example, an individual account and a separate joint account with a spouse), the broker is not required to track this as a wash sale.

Brokers sent out 1099-Bs for 2011 tax season too early. Brokers must account for buy/sells in January 2012 that may trigger a wash sale in December 2011. For example, a retail investor buys and sells XYZ stock on December 22, 2011, and then buys that stock again on January 15, 2012. The purchase on January 5 triggers a wash sale that should be reported on 1099-Bs for 2011. However, in the rush to get out 1099-Bs by the February 15 deadline, many firms went to the printers in early January. Thus retail investors must wait for a corrected Form 1099-B, or they will fill out their tax forms improperly.

Further exacerbating the lack of harmonization between the broker and investor rules, Celent has encountered several instances in which the tax software has the ability to import 1099-B data into the new Form 8949, but it does not verify the accuracy of the 1099-Bs. Therefore, tax professionals are unsure whether this data actually takes into account all of the above-mentioned differences between investor and brokerage reporting processes.

Lastly, broker feedback indicates that many of them are not confident that their back office tax-accounting solutions are properly calculating wash sales. Given how few back office solutions have focused on wash sales prior to the 2008 regulations, such concerns are justified.

Other Retail Investor Challenges

In addition to the disparate reporting requirements between brokers and retail investors, cost basis reporting regulations have engendered several changes for the retail investor. These changes are outlined below.

Selecting tax lot methods by settlement date. Unless told otherwise by settlement date, brokers revert to the default lot closing method for sell orders (First In, First Out for stocks, and average cost for mutual

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funds). Such standard lot methods may not be tax-efficient for the retail investor, whose goal is to minimize short-term gains and maximize short-term losses.

Although the taxpayer has always been required to make a specific tax lot election on or before the settlement date, investors were often able to select a different lot method when filing tax forms. Since brokers were not required to file 1099-Bs to the IRS, such discrepancies between a tax filer's Schedule D and 1099-Bs were overlooked. Federal tax regulations are now mandating enforcement of this settlement date deadline, so cost basis information reported by the brokerage firm on a Form 1099-B can be matched to the cost basis information reported by taxpayers on their Federal income tax returns.

A broker must actively inform customers of its default basis determination and allow investors to select a different lot method from the default. Brokers are typically allowing investors to select specific lot methods in the following ways:

- Written letter to the brokerage firm.
- Contacting an advisor or help desk by phone or email.
- Empowering clients to select their lot method online via client web portals.
  - This method of indicating lot selection, however, is less common. Celent recommends that more firms allow clients to make standing orders on lot selection, or change their lot selection order in real time via the web.

While brokers have been relatively successful in facilitating alternative lot selection, the advisor is legally unable to directly recommend any lot method. Instead, firms recommend that clients consult a tax advisor for guidance. This ultimately creates a gap between client needs and broker service levels as it relates to tax efficient trading.

Complexity of the new 2011 tax forms. In previous years, taxpayers recorded the acquisition date, sale date, and capital gains and losses from investment transactions on the IRS Schedule D or D-1 of the Form 1040 and could attach additional forms. Starting this year, however, the IRS has released a form called "Form 8949, Sales and Other Dispositions of Capital Assets" to standardize reporting and to avoid the attachment of different forms with different formats. The Schedule D has been reformatted to serve as a summary of all transactions.

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The addition of any new form increases the reporting burden for the taxpayer, but the complexity of Form 8949 creates substantial new challenges. Figure 4 in the Appendix provides a visual reference to the description of the form below:

The form is broken down into two parts. In Part I, taxpayers report short-term capital gains/losses; in Part II, taxpayers report long-term capital gains/losses. In addition to breaking down and reporting transactions as long-term or short-term gains/losses, investment sales are broken down into three categories:

- Sales of securities recorded on 1099-Bs and for which cost basis is provided to the IRS (covered securities).
- Sales of securities recorded on 1099-B and for which no cost basis is required (non-covered securities).
- Sales of investment assets for which no 1099-B is received.

For each of the three sales categories, a new Form 8949 must be filled out. Thus, an investor may need to organize his investments into a total of six different categories: long-term and short-term gain/loss transactions (recorded on each 8949) on three different forms (a Form 8949 for each type of investment sale). Particularly worrisome for retail investors is reporting transactions of non-covered securities and providing the adjustments, since broker 1099-B forms do not need to provide the necessary adjustment information.

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Tax Services for Retail Investors

Types of Services

Tax services for individuals and for companies is a multi-billion dollar industry. Retail investors have a vast array of services to choose from when it comes to filing taxes. There are plenty of CPA firms as well as online software providers that are willing to help with tax preparation, either electronically or in person. Banks, brokers, custodians, and other financial entities usually work with accounting firms specialized in tax practices. Table 1 highlights the types of firms, the largest in each type, and their area of focus. The largest firm, H&R Block, generates the majority of its revenue from tax return preparation for individuals.

Table 1: Selected Tax Services Firms

Type of Firm	Sample Firms	Leaders of Its Type	Service Provided	Service Delivery
Accounting Firm	KPMG, Ernst & Young, PWC, Deloitte, Grant Thornton	Pricewaterhouse Coopers (Revenue: US$2.5 billion)	To financial institutions: tax compliance, tax accounting, advisory services, education, and training.	Mostly in-person.
CPAs, Tax Specialist Firm	H&R Block, Liberty Tax	H&R Block (Revenue: US$2.9 billion)	To retail investors and business traders: tax preparation, trade accounting, and education.	Online and in-person. When only online, support is provided via email or chat or phone consultation.
Accounting Software	TurboTax, H&R Block At Home	TurboTax (Revenue: US$1.3 billions)	Tax filing, online education on tax subject areas	Online or via software

Source: Firms, Celent

The IRS' new cost basis reporting rules pose a significant challenge to brokers and investors. As such, tax preparers (including CPA firms and specialty tax firms) are working with both retail investors and financial entities to help them deal with the discrepancies found between 1099Bs and other tax forms such as 8949s and Schedule D and are providing advice and guidance on what to do when errors emerge. From a firm's perspective, cost basis reporting requires services that help address the operational impact and that help them manage the systems currently in place.

The types of tax services provided to both retail investors and firms can be summarized as follows:

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Services. Tax services are typically provided either directly to retail investors or to financial entities. Tax planning services help plan for taxes for the current year and prepare tax returns for the past year. In addition to tax preparation, investors use these firms to make sure that their trade accounting is accurate and to minimize investment expenses. Increasingly, tax firms are providing extended services around gift and estate tax planning, and family office services that include outsourced accounting services, tax and financial advice, and technical support to ultra-high net worth individuals and families.

Technology. Services around technology advice or system build are provided by some of the larger accounting firms. These services revolve around improving systems that can help brokerages or other financial entity firms to comply with current and future requirements. Improvements to software and hardware also include building cost basis engines internally or using an external third party cost basis vendor.

Consulting. Consulting services include a variety of aspects, depending on the type of firm that is delivering the work. Services can include advice on maintaining portfolio balances and investment management services, advice on business requirements to change business processes, and helping clients assess operational impact of the new rules. Making sure internal processes are effective is critical for firms to manage costs and remain successful.

Education. Providing education on the new IRS rules to both retail investors and financial institutions has a been a priority for all firms dealing with tax services. Tax education has been offered in multiple ways including online literature, blogs, videos, webinars, etc. Larger accounting firms and CPA firms also provide services on site, including training/education for internal staff at financial institutions.

Fees

Charges for tax services are provided in a variety of formats, depending on the firm providing the service and the recipient of the service. The usual industry practice among the large accounting firms for tax services geared toward financial institutions is to charge for the time spent on the job. There are some cases where more than one tax specialist gets involved on one account, and therefore charges will be higher.

For tax services directly geared at retail investors, there is a vast number of pricing structures available in the industry. The average cost for a tax consultation and preparation with an expert CPA can range

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greatly from US$200 to US$600, depending on the complexity of the retail investors' tax situation and income sources. For high net worth (HNW) individuals with a variety of income sources, and for active traders with hundreds of trades, tax preparation fees can be in the thousands of dollars. CPA firms can charge per hour, per form, or based on the complexity of the filing. The difficulty around the mismatches between the new Form 8949 and 1099-Bs has led to some confusion across accounting practices as how to charge for a service, since it often requires a significant outlay of time and calculation. To compensate for the extra work, tax preparers are charging the client for extra time spent, or by form that needs to be filled out. Some firms have even stopped signing tax returns until they receive the correct information to fill out the Schedule Ds. In addition to charging on an hourly basis for extra time spent, tax professionals are also billing based on a per transaction and per form basis, charging set fees for extra transactions and form preparation as a result of the cost basis reporting requirements. However, because it is possible to spend hours of research on reconciling one transaction, the tax expert cannot always charge for "true time spent" on these new forms.

If the retail investors opt to choose an online method for filing taxes, ranges are between US$0 and $150. There is the option to file online or via downloadable software. Most times there is no direct consultation with a tax specialist through this channel. However, there are plenty of variations to an online service, which add to the pricing of only filing through the online channel. For example, some firms allow investors to submit online using their software and also have a phone consultation with a specialist.

Online offerings have become a good target for all types of investors. There is software and services for the more active traders and also for the less sophisticated investor. The more active investor will also pay for extra consultation services and perhaps prefer the personal communication with the tax specialist.

Partnerships

Behind the scenes of tax preparation services, there are many companies that collaborate with each other to ultimately provide the best tax advice to retail customers. Large accounting firms partner with brokers or other financial institutions to provide them with the tax advisory process and guide them on the best technology to use to support cost basis reporting. Tax specialty firms work with cost basis technology providers to help them implement the right technology to help end customers in the tax filing process with the appropriate tools.

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Market Size and Revenue Opportunity

Capitalizing on the “do it yourself” attitude of investors, tax software like TurboTax and TaxAct have seen yearly gains, much to the detriment of CPAs and traditional tax firms. As of March 12, 2012, TurboTax reported over 16 million subscriptions (a 7% yearly increase) of its product. Recognizing the shifting winds, many large tax firms such as H&R Block and Liberty Tax also now offer online “do it yourself” software options to supplement their traditional branch presence. This channel has been growing for these firms, evidenced by the yearly increase of tax filers using H&R Block’s digital solutions. H&R Block At Home (digital version) has seen a 10% yearly increase to nearly 10 million subscriptions, becoming a tax software giant in its own right.

However, the new cost basis reporting requirements present an opportunity for tax preparers to offer specialized services and regain lost market share. Tax firms’ marketing expertise and branch presence will be able to capitalize on retail investor confusion as its relates to the new requirements and be able to provide a level of guidance not available through tax software. These firms will still market their online solutions, but will also offer phone consultation services or specialized technology around the Form 8949s.

Market Sizing and Revenue Opportunities

In 2012, the IRS expects to receive over 144 million tax returns. However, tax services designed to address cost basis reporting requirements are relevant only to those who have investment accounts. As such, the new market opportunity for tax professionals is not the 144 million Federal tax filers, but the number of retail investors. Furthermore, since couples often file jointly and can file a joint Form 8949 and Schedule D, the opportunity for tax professionals around cost basis reporting services is more accurately the number of retail investor households. Celent estimates that there are approximately 25 million households holding investment accounts, and approximately 65 million total retail investors.

It is unrealistic to assume that every investor will seek a tax professional’s help in filing tax returns. Celent has, therefore, determined that approximately 20–25% of all investor households will seek help by going to a CPA or a specialty tax firm for filing their taxes and for a consultation from a tax specialist. This amounts to approximately 6 million households. When sizing the revenue opportunity for tax professionals, one must understand the fees that tax preparers are likely to charge for their services. Because tax firms now offer online and in-person services, there are two sets of fees to consider. As such, Celent will break down the revenue opportunity by full service and by online channels.

Additional Revenue Opportunity—Full Service Tax Preparation

In this case, we are defining "full service" tax preparation to include fully outsourced tax form preparation. This also includes in-person consultations regarding tax lot method selection and other inquiries.

In order to size the number of investors using full tax services versus using online tools, Celent has looked at the channel breakdown at firms that offer both full service and e-file options. Based on its research, Celent has determined that approximately 65% of investor households using CPAs or tax firms (6 million) will file via a full service offering. This amounts to approximately 3.9 million households.

Fees on services as they relate to filing and consultation on Schedule Ds and Form 8949s vary widely, depending on the type of professional, the type of investor, the complexity of the transactions, and the number of transactions. Given the significant variability in the charges, Celent will provide an estimate of the average fees charged for tax preparation services around recording short-term/long-term capital gains and losses. This estimate will help us calculate the revenue opportunity for tax professionals.

In the past, tax preparers would charge a fixed fee of, on average, US$40 for the first six entries on a Schedule D, an additional US$12 fee for each researched item, plus an additional fee of US$7 for each transaction beyond the initial six. For traditional investors with little trade activity, the fees related specifically to filing a Schedule D therefore ranged between US$40 to US$100. For active traders or HNW individuals, the charges could be many hundreds of dollars. It is important to note that these fees do not include tax preparation services related to other aspects of wealth and income that are required for a full Federal income tax filing. As has been mentioned, the full cost of tax preparation varies depending on the sources of wealth and the number of forms being filed, but the average total cost of tax preparation for the typical retail investor can range between US$200 to US$600, with costs being significantly larger for HNW taxpayers or active traders.

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Celent expects that the addition of a new Form 8949, the new format of the Schedule D, and the challenges of reconciling 1099-Bs with the transactional detail on Form 8949s are likely to increase fees for tax services related to reporting capital gains/losses. Furthermore, the variability of fees based on the complexity of the forms is likely to be even greater than it has been in the past. Tax professionals serving the HNW investors and active traders are likely to take many extra hours of additional research going through hundreds of trades and reconciling 1099-B information with Form 8949s. However, CPAs and tax professionals servicing the average investor, who trades only a handful of times per year, are unlikely to face the same reconciliation challenges. As such, this professional's fees will remain largely the same as in prior years.

In order to outline the additional revenue generated by the new cost basis reporting regulations, Celent analyzed the potential additional fees charged as a result of these new requirements. Celent estimates that the new reporting requirements and consultation services will generate an additional US$80 in fees for each investor household's tax filing. It is important to note that this is an average number, and those tax professionals serving the HNW individuals are likely to charge significantly more, while many tax professionals serving the traditional investor customer segment are likely to charge less.

This additional revenue per tax filing is based on the following assumptions:

- The Form 8949 replaces the original Schedule D, where cost basis information on individual transactions is recorded. It is expected that tax professionals will increase their fees for recording the first six transactions by US$15 (from US$40 to US$55) for **each** new Form 8949. Since investors often hold different assets classes, Celent expects that tax professionals will need to file at least two Form 8949s (for covered and uncovered securities), creating a total cost of US$30 in additional fees. Research fees required to record these transactions are considered separate charges;
- The Schedule D is now a summary form. Filling out this summary form will be a new, but quick, task for the tax professional. Tax professionals will charge a new US$10 to US$15 fee for filling out the Schedule D;
- The hourly rate for research and consultation is likely to remain the same, but tax professionals are expected to spend more hours conducting research due to incomplete data and difficulties reconciling forms. As such, it is likely

that retail investors will see an additional US$40 charge, on average, for fees related to extra consultation and research hours. This estimate considers that many traditional investors will require little to no research for their transactions, while HNW and active traders may require many additional hours.

- Celent believes that the bulk of retail investors, whose trade activity comprises of around six to ten trades per year, are unlikely to be charged all of the above fees and unlikely to see much of a rise in their tax preparation forms. However, the added fees charged to HNW customers are likely to well exceed these estimates (with additional charges that could well extend into the hundreds of dollars) due to the complexity of their portfolios and the number of transactions recorded on 1099-Bs. Thus, the additional fees of US$80 is an average measure.

Figure 1 on page 17 outlines Celent's market sizing of the additional revenue opportunity for tax preparers through the full service channel. The high estimate of US$310 million in additional revenue in 2012 is based on these assumptions: 1) There are 6 million households (around 25% of the 25 million US households holding investment accounts) that are likely to use CPAs or tax firms for preparation services; 2) There are 3.9 million investor households likely to file using a full service tax preparer versus the same firm's online software; and 3) Tax preparers are going to charge US$80 more for services around Form 8949 and Schedule D reporting and for consultation costs.

Going forward, this estimate includes growth in the retail investor population as well as a growing penetration rate of households using tax services. The growing adoption rate is due to the following factors: 1) As cost basis reporting for mutual funds and fixed income assets (household investors hold US$4.5 and US$4.7 trillion respectively in these asset classes) get phased in for the 2012 and 2013 tax reporting seasons, this will continue to drive increased opportunity for tax professionals. 2) Celent expects growing revenue opportunity for professionals who provide value-add services such as tax efficient advice related to lot sale methods. As a result, the penetration rate used in the high estimate grows from 25% in 2012 to 32% by 2015.

The low estimate of US$260 million is based on the assumptions that there are fewer households using tax preparation services (5 million households or 20% of the total US household population) and that the penetration rate will remain lower through 2015, growing from 20% in 2012 to 27% by 2015.

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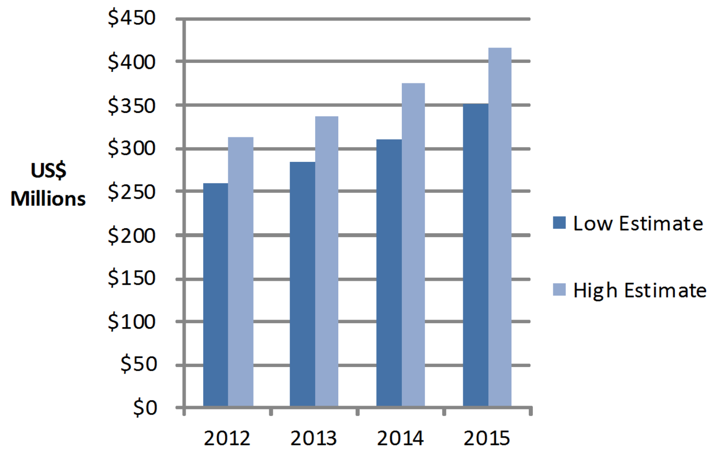
Figure 1: Additional Revenue for Tax Firms—Full Service Channel



Source: Interviews, Celent Estimates

Online Services

A number of tax specialty firms such as Liberty, Jackson Hewitt and H&R Block are now competing with TurboTax in the digital channel by offering online tax software or web versions. To address the cost basis requirements, these online products can offer new tools such as automated generation of 1099-Bs and Schedule Ds. In this case, the tax firm partners with a number of different brokerages so that the tax firm can import transactional data directly into the 8949 and Schedule D forms. Thus, the investor filing online simply needs to select the brokerage accounts he has, and the tax software will pull transactional information directly into online Form 8949. Tax firms have also recognized that those filing online are more likely than in previous years to require a phone consultation, and are offering such services.

Evaluating increased fees related to cost basis requirements is difficult for the online channel. The price of software and phone consultation rates are largely the same each year. There are, however, data points that help determine the added costs. One such data point is the difference between a tax firm's pricing of its "Basic" software and "Deluxe" software. Typically the Deluxe product costs US$10 more and offers additional service/tools around investments. It is unlikely that this US$10 is due solely to differences in cost basis reporting, so Celent assumes that a portion of this can be considered increased fees generated from cost basis reporting. Celent assumes that prices will remain the same as in year's past for phone consultations, but that the frequency of using a phone consultation will go up due to reconciliation

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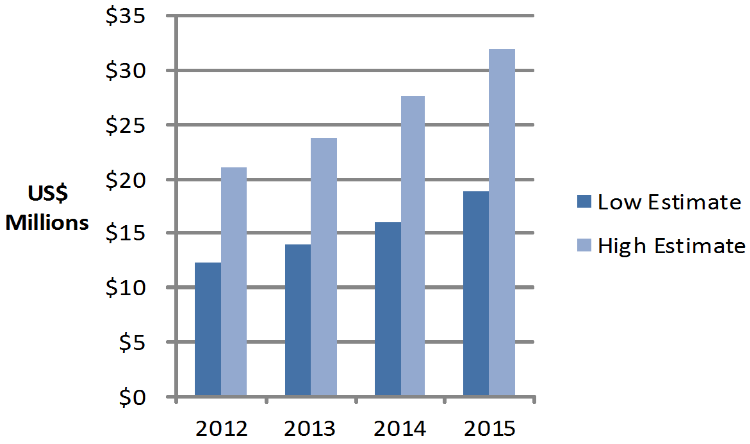
questions. Some firms do not charge for this service, whereas others do. As such, Celent assumes that an average of US$5 per filer will be generated as a result of increased phone consultations. Thus, Celent assumes that US$10 in additional fees will be embedded in the online service channel for investors.

Figure 2 on page 18 outlines Celent's market sizing of the new revenue opportunity for tax preparers through the online channel. The high estimate of US$21 million in additional revenue in 2012 is based on the some of the same assumptions that were outlined in the full service model: 1) There are 6 million investor households that are likely to use tax firms or CPAs for preparation services; 2) 2.1 million households with investments and that are using tax firms or CPAs will use online offerings (35% using online channels and 65% using full service channels equals 6 million households); 3) Going forward, this estimate also includes growth in the retail investor population as well as growing penetration rates of both use of online software and of households using tax specialty firms for services. The penetration rate used in the high estimate grows from 25% in 2012 to 32% by 2015. The unique assumption for the online channel will be the added revenue per filer. Here Celent assumes that US$10 of new fees will be generated for the added Form 8949 and Schedule D services as well as consultation costs.

The low estimate of US$12 million is based on the assumption that there are fewer households using tax preparation services (5 million households or 20% of the total US household population), and that the penetration rate will remain lower through 2015, growing from 20% to 28%. Additionally, the low estimate includes a lower fee per tax filing. Instead of the US$10 in additional fees, the low estimate includes US$7 in additional fees.

Figure 2: Additional Revenue for Tax Firms—Online Channel



Source: Interviews, Celent Estimates

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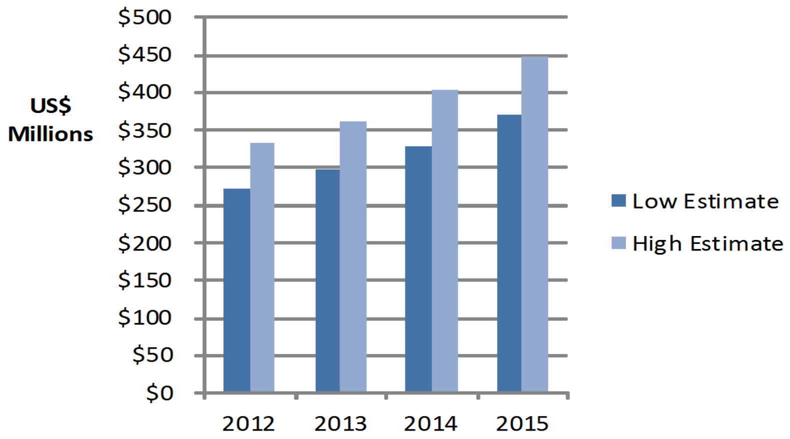
Total Revenue Opportunity

Figure 3 provides a consolidated view of the revenue opportunity for tax firms and CPAs as a result of the new cost basis reporting regulations. This estimate combines the online and full service channel and provides a low and high estimate. The high estimate of US$330 million will reach close to US$450 million by 2015; the low estimate of US$270 million in 2012 will reach US$370 million by 2015.

It is important to note that while all investors will see increased fees due to cost basis reporting regulations, the majority of this revenue opportunity will be derived from the HNW and active trader population, whose trading activity is far more complex than the traditional investor's. Thus, those tax professionals servicing the high-end market are likely to see more of this revenue opportunity than those tax professionals whose clients have simple trading records and 1099-Bs.

Figure 3: Additional Revenue for Tax Specialists—Consolidated Look



Source: Celent Estimates

Opportunities to Expand Relationship with Value-Add Services

The above revenue sizing elucidates the opportunity for tax professionals specifically as it relates to preparing forms, providing consultation around cost basis reporting, and helping select lot methods. Celent also believes that these new requirements provide tax professionals with an opportunity to expand their relationships with existing clients.

Services around guiding tax return filing and tax lot selection provide an opportunity for tax professionals to not only supply accurate cost basis information or offer tax efficient lot selection, but also segue into a larger relationship, where CPAs and professionals can offer a fully "tax efficient" strategy as it relates to all of their financial holdings.

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This is a particularly strong opportunity for tax professionals to expand their relationships with high net worth (HNW) and ultra high net worth clients (UHNW), for whom tax efficient trading is vital, but who also use a variety of other services as it relates to managing their wealth. Tax professionals currently offering their HNW clients guidance around tax return preparation and tax efficient lot selection also have an opportunity to provide extended services around a fully tax-aware strategy as it relates inheritance planning, gifting, estate planning, philanthropy, etc.

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Solutions to Better Service Clients

The Schedule D and 8949 reporting is a tremendously time-consuming process fraught with errors. Investors, or the tax professionals they hire, may spend hours researching specific transactions and reconciling 1099-Bs with Form 8949s. Furthermore, the 1099-Bs of active traders may have hundreds (if not thousands) of transactions that must be reported on the Form 8949. However, retail investors are unlikely to devote the necessary time, and many tax professionals are unable to charge their high value clients what their true "time spent" was.

Technology providers have come to the market offering tools designed specifically to improve the retail investor experience as it relates to tax reporting. These tools are sold directly to the investor, to tax professionals to improve the speed and accuracy of their reporting, and to brokers.

Many brokers have partnered with technology providers to offer automated Schedule D generators. These tools utilize the underlying cost basis reporting engines to generate the 1099-B, the Schedule D, and 8949 Forms. Such tools alleviate many of the burdens placed on the retail investor and can be promoted as a value-add to the value proposition. The tools can be offered free of charge to the retail investor, or the broker can charge a monthly/yearly subscription. One possible downside to these tools, however, is that they cannot take into consideration transactions occurring at other brokerages and thus cannot consider cross-account wash sales. Technology providers have also been offering brokers "BestTax" lot selection tools that automatically selects the most tax efficient lot to be sold when an investor sells a position. Brokers can market this as an added service offering for high-value clients.

Celent has also seen technology providers offer tools directly to the retail investor or tax professional. One such tool automates Schedule D and Form 8949 reporting by partnering with a list of brokers and importing all transactional details straight from the brokers. In doing so, this tool bypasses the need for the investor to review and input his 1099-B information into the 8949. These tools, while useful, unfortunately do not illuminate and explore the differences between broker-provided 1099-B forms and 8949 forms. As such, the retail investor and tax professional would need to research these differences.

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Another tool available for the retail investor or tax professional is designed to improve the accuracy and speed of reconciling differences between 1099-Bs and the Form 8949s. In these cases, 1099-B transactional information is uploaded, and via cost basis calculators utilizing logic designed for the retail investor (for example, cross-account wash sales are tracked), the tool will compare and highlight any cost basis variance between the tool's calculations and the 1099-Bs. This 1099-B information can be uploaded in a number of ways: 1) The investor or his tax professional may manually input the transactions into an Excel spreadsheet; 2) The information is manually inputted into the tool's standard online form; 3) The professional can use a tool to convert paper 1099-Bs into a convertible online format. Once the investor or tax professional is able to observe the variance, he can accept the tool's transactional data (including cost basis adjustment) or do more research. Once the variance has been resolved, he may automatically generate the relevant Form 8949s, with all transactions placed in their proper categories, as well as the summary Schedule D form. For tax professionals this may eliminate hours of time spent, allowing their charges and fees to more accurately reflect the time spent on tax forms and allowing the professional to focus more on providing value-add services such as inheritance planning, gifting, tax advisory, among others.

Typically these tools are sold to the investor on a fee per transaction basis, with the cost of each transaction decreasing with higher volumes. Such a pricing model is also relevant for independent tax professionals with a small number of high-value clients. For major tax servicing firms such as H&R Block or Liberty Tax Services, the technology provider would likely charge a monthly/yearly subscription fee, reducing the cost per transaction to well below US$1 per transaction.

Cost basis regulations have generated consternation since early 2009. Now that tax reporting season is upon us, retail investors and tax specialists are experiencing new challenges in tax reporting. These new reporting requirements, however, should also be viewed as an opportunity for tax specialists to regain ground lost against the "do-it-yourself" tax software. These specialists can capitalize on the added complications investors have experienced in trying to fill out their Form 8949s, while reconciling any differences with their 1099-Bs. By providing guidance and research in these areas, tax accountants can improve their value proposition. Additionally, tax specialists should remain open to providing year-round service regarding lot selection so that an investor can maximize tax-efficient trading strategies. Such offerings will make tax advisory a much valued service, and by utilizing technology, tax accountants can reduce time and errors in filling out reports, and improve their bottom line.

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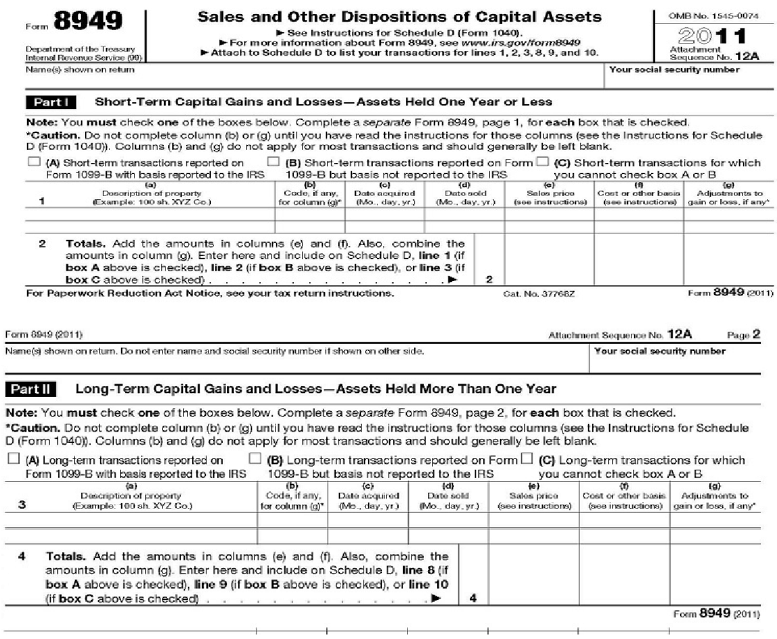
Appendix

Figure 4 provides a snapshot of 2011 Form 8949. The form is broken down into two parts. In Part I, taxpayers report short-term capital gains/losses; in Part II, taxpayers report long-term capital gains/losses. In addition to breaking down and reporting transactions as long-term or short-term gains/losses, investment sales are broken down into three categories:

- Sales of securities recorded on 1099-Bs and for which cost basis is provided to the IRS (covered securities).
- Sales of securities recorded on 1099-B and for which no cost basis is required (non-covered securities).
- Sales of investment assets for which no 1099-B is received.

Figure 4: Snapshot of Form 8949



Form **8949** Department of the Treasury Internal Revenue Service (99)

Sales and Other Dispositions of Capital Assets

► See Instructions for Schedule D (Form 1040).
► For more information about Form 8949, see *www.irs.gov/form8949*
► Attach to Schedule D to list your transactions for lines 1, 2, 3, 8, 9, and 10.

OMB No. 1545-0074 **2011** Attachment Sequence No. **12A**

Name(s) shown on return | **Your social security number**

Part I **Short-Term Capital Gains and Losses—Assets Held One Year or Less**

Note: You **must** check **one** of the boxes below. Complete a *separate* Form 8949, page 1, for **each** box that is checked.
***Caution.** Do not complete column (b) or (g) until you have read the instructions for those columns (see the Instructions for Schedule D (Form 1040)). Columns (b) and (g) do not apply for most transactions and should generally be left blank.

☐ **(A)** Short-term transactions reported on Form 1099-B with basis reported to the IRS ☐ **(B)** Short-term transactions reported on Form 1099-B but basis not reported to the IRS ☐ **(C)** Short-term transactions for which you cannot check box A or B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Code, if any, for column (g)*	(c) Date acquired (Mo., day, yr.)	(d) Date sold (Mo., day, yr.)	(e) Sales price (see instructions)	(f) Cost or other basis (see instructions)	(g) Adjustments to gain or loss, if any*
2	**Totals.** Add the amounts in columns (e) and (f). Also, combine the amounts in column (g). Enter here and include on Schedule D, **line 1** (if **box A** above is checked), **line 2** (if **box B** above is checked), or **line 3** (if **box C** above is checked) . . . ►			2			

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37768Z Form **8949** (2011)

Form 8949 (2011) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Do not enter name and social security number if shown on other side. | **Your social security number**

Part II **Long-Term Capital Gains and Losses—Assets Held More Than One Year**

Note: You **must** check **one** of the boxes below. Complete a *separate* Form 8949, page 2, for **each** box that is checked.
***Caution.** Do not complete column (b) or (g) until you have read the instructions for those columns (see the Instructions for Schedule D (Form 1040)). Columns (b) and (g) do not apply for most transactions and should generally be left blank.

☐ **(A)** Long-term transactions reported on Form 1099-B with basis reported to the IRS ☐ **(B)** Long-term transactions reported on Form 1099-B but basis not reported to the IRS ☐ **(C)** Long-term transactions for which you cannot check box A or B

3	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Code, if any, for column (g)*	(c) Date acquired (Mo., day, yr.)	(d) Date sold (Mo., day, yr.)	(e) Sales price (see instructions)	(f) Cost or other basis (see instructions)	(g) Adjustments to gain or loss, if any*
4	**Totals.** Add the amounts in columns (e) and (f). Also, combine the amounts in column (g). Enter here and include on Schedule D, **line 8** (if **box A** above is checked), **line 9** (if **box B** above is checked), or **line 10** (if **box C** above is checked) . . . ►			4			

Form **8949** (2011)

Source: IRS

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