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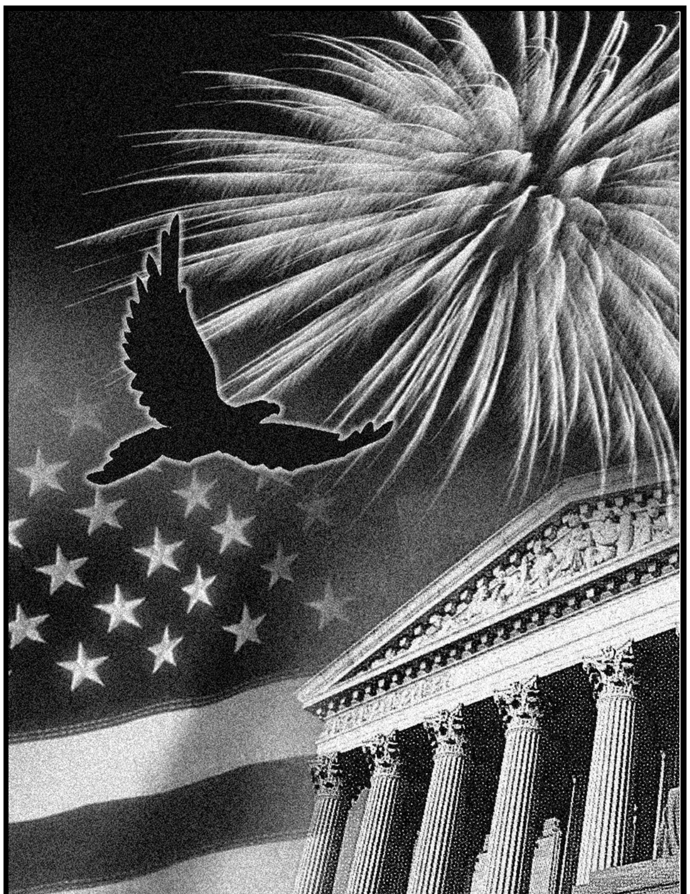
Mutual Fund Distributions

For use in preparing

2008 Returns



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What's New

Maximum tax rate on qualified dividends and net capital gain reduced. Beginning in 2008, the 5% maximum tax rate on qualified dividends and net capital gain (the excess of net long-term capital gain over net short-term capital loss) is reduced to 0 (zero)%. This reduction applies for both regular and alternative minimum tax. The 15% maximum tax rate on qualified dividends and net capital gain has not changed.

Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication provides federal income tax information for individual shareholders of mutual funds or other regulated investment companies, including money market funds. It explains how to report distributions paid to you by a mutual fund and any expenses connected with your investment. In addition, it explains how to report undistributed long-term capital gains. It also explains how to figure and report your gain or loss

Mar 24, 2009

when you sell, exchange, or redeem your mutual fund shares. A comprehensive example, with filled-in forms, appears at the end of the publication.

In this publication, the term “mutual fund” means a mutual fund or other regulated investment company.

Mutual fund. A mutual fund is a regulated investment company generally created by “pooling” funds of investors to allow them to take advantage of a diversity of investments and professional management.

Money market fund. A money market fund is a mutual fund that tries to increase current income available to shareholders by buying short-term market investments.

Money market funds pay dividends and should not be confused with bank money market accounts that pay interest.

Qualified retirement plans and IRAs. The rules in this publication do not apply to mutual fund shares held in individual retirement arrangements (IRAs), section 401(k) plans, and other qualified retirement plans. The value of the mutual fund shares and earnings allocated to you are included in your retirement plan assets and stay tax free generally until the plan distributes them to you. The tax rules that apply to retirement plan distributions are explained in the following publications.

- Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans).
- Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans).
- Publication 575, Pension and Annuity Income.
- Publication 590, Individual Retirement Arrangements (IRAs).
- Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

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Tax questions. If you have a tax question, check the information available on www.irs.gov or call 1-800-829-1040. We cannot answer tax questions sent to either of the above addresses.

Useful Items

You may want to see:

Publication

- ❏ **550** Investment Income and Expenses

Form (and Instructions)

- ❏ **Schedule B (Form 1040)** Interest and Ordinary Dividends
- ❏ **Schedule D (Form 1040)** Capital Gains and Losses
- ❏ **Schedule 1 (Form 1040A)** Interest and Ordinary Dividends for Form 1040A Filers
- ❏ **1099-B** Proceeds From Broker and Barter Exchange Transactions
- ❏ **1099-DIV** Dividends and Distributions
- ❏ **2439** Notice to Shareholder of Undistributed Long-Term Capital Gains
- ❏ **4952** Investment Interest Expense Deduction

See How To Get Tax Help near the end of this publication for information about getting these publications and forms.

Tax Treatment of Distributions

A distribution you receive from a mutual fund may be an ordinary dividend, a qualified dividend, a capital gain distribution, an exempt-interest dividend, or a nondividend distribution. The fund will send you a Form 1099-DIV or similar statement telling you the kind of distribution you received. This section discusses the tax treatment of each kind of distribution, describes how to treat reinvested distributions, and explains how to report distributions on your return.

CAUTION *You may be treated as having received a distribution of capital gains even if the fund does not distribute them to you. See Undistributed capital gains under Capital Gain Distributions.*

Community property states. If you are married and receive a distribution that is community income, one-half of the distribution is generally considered to be received by each spouse. If you file separate returns, you must each report one-half of any taxable distribution. See Publication 555, Community Property, for more information on community income.

If the distribution is not considered community income under state law and you and your spouse file separate returns, each of you must report your separate taxable distributions.

Share certificate in two or more names. If two or more persons, such as you and your spouse, hold shares as joint tenants, tenants by the entirety, or tenants in common, distributions on those shares are considered received by each of you to the extent provided by local law.

Certain year-end dividends received in January. Dividends declared and made payable by mutual funds in October, November, or December are considered received by shareholders on December 31 of the same year even if the dividends are actually paid during January of the following year.

Tax-exempt mutual fund. Distributions from a tax-exempt mutual fund (one that invests primarily in tax-exempt securities) may consist of ordinary dividends, capital gain distributions, nondividend distributions, or undistributed capital gains like any other mutual fund. These distributions generally are treated the same as distributions from a regular mutual fund.

Distributions designated as exempt-interest dividends are not taxable. (See Exempt-Interest Dividends, later.)

Ordinary Dividends

An ordinary dividend is a distribution by a mutual fund out of its earnings and profits. Include ordinary dividends that you receive from a mutual fund as dividend income on your individual income tax return.

Ordinary dividends are the most common type of dividends. They will be reported in box 1a of Form 1099-DIV or on a similar statement you receive from the mutual fund.

Qualified dividends. Many ordinary dividends you received are also classified as qualified dividends. The amount of your qualified dividends will be shown in box 1b of Form 1099-DIV or on a similar statement you get from the mutual fund.

Qualified dividends are taxed at the same maximum tax rates that apply to a net capital gain. They are taxed at 15% if the regular tax rate that would apply is 25% or higher. They are taxed at 0% (zero%) if the regular tax rate that would apply is lower than 25%.

To be a qualified dividend subject to the 0% or 15% rate, a dividend must meet all of the following requirements.

1. The dividend must have been paid by a U.S. corporation or a qualified foreign corporation. See chapter 1 of Publication 550 for the definition of a qualified foreign corporation.
2. The dividend must not be of a type excluded by law from the definition of a qualified dividend. See chapter 1 of Publication 550 for a list of these types of dividends.
3. You must meet the holding period requirement (discussed next).

Holding period. You must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock will not receive the next dividend payment. When counting the number of days you held the stock, include the day you disposed of the stock, but not the day you acquired it.

More information. See chapter 1 of Publication 550 for more information about qualified dividends.

Capital Gain Distributions

These distributions are paid by mutual funds from their net realized long-term capital gains. The Form 1099-DIV (box 2a) you receive or the fund's statement will tell you the amount you are to report as a capital gain distribution. Capital gain distributions are taxed as long-term capital gains regardless of how long you have owned the shares in the mutual fund.

Undistributed capital gains. Mutual funds may keep some of their long-term capital gains and pay taxes on those undistributed amounts. You must report your share of these amounts as long-term capital gains, even though you did not actually receive a distribution. You can take a credit for your share of any tax paid because you are considered to have paid it.

Form 2439. The fund will send you Form 2439, instead of Form 1099-DIV, showing your share of the undistributed long-term capital gains in box 1a and any tax paid by the mutual fund in box 2. Attach Copy B of Form 2439 to your return.

Increase to basis. When you report undistributed capital gains from a mutual fund, you must increase your basis in the shares. You must keep Copy C of Form 2439 to show this increase. See Adjusted Basis, later.

Exempt-Interest Dividends

A mutual fund may pay exempt-interest dividends to its shareholders if it meets certain requirements. These dividends are paid from tax-exempt interest earned by the fund. Since the exempt-interest dividends keep their tax-exempt character, do not include them in income. However, you may need to report them on your return. See Information reporting requirement, next. The mutual fund should send you a Form 1099-INT showing your exempt-interest dividends. Exempt-interest dividends should be shown on Form 1099-INT, box 8.

Information reporting requirement. Although exempt-interest dividends are not taxable, you must report them on your tax return if you are required to file. This is an information reporting requirement and does not convert tax-exempt interest to taxable interest. Also, this income is generally a "tax preference item" and may be subject to the alternative minimum tax. Form 1099-INT, box 9, should show the tax-exempt interest subject to the alternative minimum tax. If you receive exempt-interest dividends, you should see Form 6251, Alternative Minimum Tax—Individuals, for more information.

Nondividend Distributions

A nondividend distribution is a distribution that is not out of earnings and profits and is a return of your investment, or capital, in the mutual fund and is shown on Form 1099-DIV, box 3.

A nondividend distribution reduces your basis in the shares. Basis is explained under Keeping Track of Your Basis, later. Your basis cannot be reduced below zero. If your basis is zero, you must report the nondividend distribution on your tax return as a capital gain. Report this capital gain on Schedule D (Form 1040). Whether it is a long-term or short-term capital gain depends on how long you held the shares.

Example. You bought shares in a mutual fund in 2004 for $12 a share. In 2005, you received a nondividend distribution of $5 a share. You reduced your basis in each share by $5 to an adjusted basis of $7. In 2006, you received a nondividend distribution of $1 per share and further reduced your basis in each share to $6. In 2007, you received a nondividend distribution of $2 per share. Your basis was reduced to $4. In 2008, the nondividend distribution from the mutual fund was $5 a share. You reduce your basis in each share to zero and report the excess ($1 per share) as a long-term capital gain on Schedule D (Form 1040).

Reinvestment of Distributions

Most mutual funds permit shareholders to automatically reinvest distributions in more shares in the fund, instead of receiving cash. You must report the reinvested amounts the same way as you would report them if you received them in cash. This means that reinvested ordinary dividends and capital gain distributions generally must be reported as income. Reinvested exempt-interest dividends generally are not reported as income. Reinvested return of capital distributions are reported as explained under Nondividend Distributions, earlier. See Keeping Track of Your Basis, later, to determine the basis of the additional shares.

How To Report

You must report mutual fund distributions on Form 1040 or Form 1040A. You cannot report mutual fund distributions on Form 1040EZ.

You cannot use Form 1040A and must use Form 1040 in either of the following situations.

- You received a nondividend distribution that must be reported as a capital gain because it is more than your basis in your mutual fund shares.
- You must report an undistributed capital gain.

Form 1040A. If you file Form 1040A, report your exempt-interest dividends on line 8b. Report your ordinary dividend distributions on line 9a and your qualified dividend distributions on line 9b. If the total of the ordinary dividends you received is more than $1,500 or you received ordinary dividends as a nominee, first report the ordinary dividends on Schedule 1 (Form 1040A), Part II, line 5. Report the total from line 6 of that schedule on Form 1040A, line 9a. Attach Schedule 1 (Form 1040A) to your return.

If you reported qualified dividends on Form 1040A, line 9b, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040A instructions.

CAUTION: *Do not include capital gain distributions as dividend income on Form 1040A or Schedule 1 (Form 1040A).*

Capital gain distributions. If you received capital gain distributions, you may have to file Form 1040. But you can report capital gain distributions on Form 1040A, line 10, instead of on Form 1040, if both of the following are true.

1. None of the Forms 1099-DIV (or substitute statements) you received have an amount in box 2b, 2c, or 2d.
2. You do not have to file Form 1040 for any other reason. (For example, you must not have any other capital gains or any capital losses.)

If you can use Form 1040A to report your capital gain distributions, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040A instructions to figure your tax.

Form 1040. If you file Form 1040, report your exempt-interest dividends on line 8b. Report your ordinary dividend distributions on line 9a and your qualified dividend distributions on line 9b. If the total of the ordinary dividends you received is more than $1,500 or you received ordinary dividends as a nominee, first report the ordinary dividends on Schedule B (Form 1040), Part II, line 5. Report the total from line 6 of that schedule on Form 1040, line 9a. Attach Schedule B (Form 1040) to your return.

If you reported qualified dividends on line 9b, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions or the Schedule D Tax Worksheet in the Schedule D instructions, whichever applies, to figure your tax.

CAUTION: *Do not include capital gain distributions as dividend income on Form 1040 or Schedule B (Form 1040).*

Capital gain distributions. If you received capital gain distributions, you report them either directly on Form 1040, line 13, or on Schedule D (Form 1040), line 13, depending on your situation. Report them on Schedule D (Form 1040), line 13, unless both of the following are true.

1. The only amounts you would have to report on Schedule D (Form 1040) are capital gain distributions from Form 1099-DIV, box 2a (or similar statement).
2. You do not have an amount in box 2b, 2c, or 2d, of any Form 1099-DIV (or similar statement).

If both of the above statements are true, report your capital gain distributions directly on Form 1040, line 13, and check the box on that line. Also, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions to figure your tax.

Undistributed capital gains. To report undistributed capital gains, you must complete Schedule D (Form 1040) and attach it to your return. Report these gains on Schedule D (Form 1040), line 11, and attach Copy B of Form 2439 to your return. Report the tax paid by the mutual fund on these gains on Form 1040, line 68, and check box a on that line.

Table 1. See Table 1 for more information on where to report your mutual fund distributions on Form 1040 or Form 1040A.

Nominees. If you received a Form 1099-DIV or Form 2439 as a nominee (that is, it includes amounts that actually belong to someone else, other than your spouse), you must file a Form 1099-DIV or Form 2439 with the Internal Revenue Service and give the actual owner a copy. See the instructions for Forms 1099 or Form 2439 for details.

If you received an ordinary dividend distribution as a nominee, report it on Schedule B (Form 1040), line 5, or Schedule 1 (Form 1040A), line 5. Under your last entry on line 5, enter a subtotal of all ordinary dividends listed. Below this subtotal, enter "Nominee Distribution" and show the total ordinary dividends you received as a nominee. Subtract this amount from the subtotal and enter the result on line 6.

If you received a capital gain distribution or were allocated an undistributed capital gain as a nominee, report only the amount that belongs to you on Form 1040A, line 10, Form 1040, line 13, or Schedule D (Form 1040), line 13, whichever is appropriate. Attach a statement to your return showing the full amount you received or were allocated and the amount you received or were allocated as a nominee.

Foreign tax deduction or credit. Some mutual funds invest in foreign securities or other foreign instruments. Your mutual fund may choose to allow you to claim a deduction or credit for the taxes it paid to a foreign country or U.S. possession. The fund will notify you if this applies to you. The notice will include your share of the foreign taxes paid and the part of the dividend derived from sources in foreign countries or U.S. possessions.

You may be able to claim a credit for income tax paid to a foreign country. However, it may be to your benefit to treat the tax as an itemized deduction on Schedule A (Form 1040). For more information on claiming a foreign tax deduction or credit, see Publication 514, Foreign Tax Credit for Individuals.

Keeping Track of Your Basis

You should keep track of your basis in mutual fund shares because you need the basis to figure any gain or loss on the shares when you sell, exchange, or redeem them.

Original basis. As explained in the following paragraphs, original basis depends on how you acquired your shares.

Adjusted basis. As described later under *Adjusted Basis*, your original basis is adjusted (increased or decreased) by certain events. You must keep accurate records of all events that affect basis so you can figure the proper amount of gain or loss.

Shares Acquired by Purchase

The original basis of mutual fund shares you bought is usually their cost or purchase price. The purchase price usually includes any commissions or load charges paid for the purchase.

Example. You bought 100 shares of Fund A for $10 a share. You paid a $50 commission to the broker for the purchase. Your cost basis for each share is $10.50 ($1,050 ÷ 100).

RECORDS When you buy or sell shares in a fund, keep the confirmation statements you receive. The statements show the price you paid for the shares when you bought them and the price you received for the shares when you disposed of them. The information from the confirmation statement when you purchased the shares will help you figure your basis in the fund.

Commissions and load charges. The fees and charges you pay to acquire or redeem shares of a mutual fund are not deductible. You can usually add acquisition fees and charges to your cost of the shares and thereby increase your basis. A fee paid to redeem the shares is usually a reduction in the redemption price (sales price).

Table 1. **Reporting Mutual Fund Distributions on Form 1040 or 1040A**

If you receive . . .	**AND . . .**	**Then report the distribution on:**	
		Form 1040 . . .	**Form 1040A . . .**
ordinary dividends (Form 1099-DIV, box 1a)	• your total ordinary dividends received are $1,500 or less, and • you did not receive any ordinary dividends as a nominee	line 9a	line 9a
	• your total ordinary dividends received are more than $1,500, or • you received ordinary dividends as a nominee	• line 9a, and • Schedule B (Form 1040), line 5	• line 9a, and • Schedule 1 (Form 1040A), line 5
qualified dividends (Form 1099-DIV, box 1b)		• line 9b, and • Qualified Dividends and Capital Gain Tax Worksheet, line 2, *or* Schedule D Tax Worksheet, line 2, whichever applies	• line 9b, and • Qualified Dividends and Capital Gain Tax Worksheet, line 2
capital gain distributions (Form 1099-DIV, box 2a)	you do not have to file Schedule D (Form 1040)	• line 13, and • Qualified Dividends and Capital Gain Tax Worksheet, line 3	• line 10, and • Qualified Dividends and Capital Gain Tax Worksheet, line 3
	you have to file Schedule D (Form 1040) (see Schedule D instructions for line 13)	Schedule D (Form 1040), line 13	you must use Form 1040; you cannot use Form 1040A
section 1250, 1202, or collectibles gain (Form 1099-DIV, box 2b, 2c, or 2d)		Schedule D (Form 1040) (see the Schedule D instructions)	you must use Form 1040; you cannot use Form 1040A
nondividend distributions (Form 1099-DIV, box 3)		generally not reported*	generally not reported*
exempt-interest dividends (Form 1099-INT, box 8)		line 8b	line 8b
undistributed capital gains (Form 2439, boxes 1a-1d)		Schedule D (Form 1040) (see the Schedule D instructions)	you must use Form 1040; you cannot use Form 1040A

* Report any amount in any excess of your basis in your mutual fund shares on Schedule D (Form 1040). Use line 8 if you held the shares more than one year. Use line 1 if you held your mutual fund shares 1 year or less.

You cannot add your entire acquisition fee or load charge to the cost of the mutual fund shares acquired if all of the following conditions apply.

1. You get a reinvestment right because of the purchase of the shares or the payment of the fee or charge.
2. You dispose of the shares within 90 days of the purchase date.
3. You acquire new shares in the same mutual fund or another mutual fund, for which the fee or charge is reduced or waived because of the reinvestment right you got when you acquired the original shares.

The amount of the original fee or charge in excess of the reduction in (3) is added to the cost of the original shares. The rest of the original fee or charge is added to the cost basis of the new shares (unless all three conditions above also apply to the purchase of the new shares).

Reinvestment right. This is the right to acquire mutual fund shares in the same or another mutual fund without paying a fee or load charge, or by paying a reduced fee or load charge.

Shares Acquired by Reinvestment

The original cost basis of mutual fund shares you acquire by reinvesting your distributions is the amount of the distributions used to purchase each full or fractional share. This rule applies even if the distribution is an exempt-interest dividend that you do not report as income.

When you acquire shares through reinvestment, keep the statements that show each date, amount, and number of full or fractional shares purchased. Keep track of any adjustments to basis of the shares as they occur.

Generally, you must know the basis per share to compute gain or loss when you dispose of the shares. This is explained under Identifying the Shares Sold*, later.*

Shares Acquired by Gift

To determine your original basis of mutual fund shares you acquired by gift, you must know:

- The donor's adjusted basis,
- The date of the gift,
- The fair market value (the last quoted public redemption price) of the shares at the time of the gift, and
- Any gift tax paid on the gift of the shares.

Fair market value less than donor's adjusted basis. If the fair market value (FMV) of the shares at the time of the gift was less than the adjusted basis to the donor at the time of the gift, your basis for gain on their disposition is the donor's adjusted basis. Your basis for loss is the FMV of the shares at the time of the gift. In this situation, it is possible to sell the shares at neither a gain nor a loss because of the basis you have to use.

Example. You are given mutual fund shares with an adjusted basis of $10,000 at the time of the gift. The FMV of the shares at the time of the gift is $9,000. You later sell the shares for $9,500. The basis for figuring a gain is $10,000, so there is no gain. There also is no loss, since the basis for figuring a loss is $9,000. In this situation, you have neither a gain nor a loss.

Fair market value equal to or more than donor's adjusted basis. If the FMV of the shares at the time of the gift was equal to or more than the donor's adjusted basis at the time of the gift, your basis is the donor's adjusted basis at the time of the gift, plus all or part of any gift tax paid on the gift, depending on the date of the gift.

For information on figuring the amount of gift tax to add to your basis, see *Property Received as a Gift* in Publication 551, Basis of Assets.

Shares Acquired by Inheritance

If you inherited shares in a mutual fund, your original basis is generally the fair market value (FMV) (the last quoted public redemption price) on the date of the decedent's death, or the alternate valuation date if chosen for estate tax purposes.

Community property states. In community property states, you and your spouse generally are considered to each own half the estate (excluding separate property). If one spouse dies and at least half of the community interest is includible in the decedent's gross estate (whether or not the estate is required to file a return), the FMV of the community property at the date of death becomes the basis of both halves of the property.

For example, if the FMV of the entire community interest in a mutual fund is $100,000, the basis of the surviving spouse's half of the shares is $50,000. The basis of the heirs' half of the shares also is $50,000.

In determining the basis of assets acquired from a decedent, property held in joint tenancy is community property if its status was community property under state law.

Shares you gave the decedent. A different basis rule applies to inherited shares that you or your spouse gave the decedent within the 1-year period ending on the date of the decedent's death if, on the date of the gift, the shares were appreciated property. In this situation, the basis of the inherited shares is the decedent's adjusted basis in them immediately before his or her death, rather than their FMV.

This basis rule also applies if the decedent's estate (or a trust of which the decedent was the grantor) sells the shares instead of distributing them to you, and you are entitled to the proceeds.

Appreciated property. Appreciated property is any property (including mutual fund shares) whose FMV is more than its adjusted basis.

Exceptions. This basis rule does not apply if the decedent died before 1982 or you gave the shares to the decedent before August 14, 1981.

Adjusted Basis

After you acquire mutual fund shares, you may need to make adjustments to your basis. The adjusted basis of your shares is your original basis (defined earlier), increased or reduced as described here.

Addition to basis. Increase the basis in your shares by the difference between the amount of undistributed capital gain you include in income and the tax considered paid by you on that income.

The mutual fund reports the amount of your undistributed capital gain on Form 2439, box 1a, and any tax paid by the mutual fund in box 2. You should keep Copy C of all Forms 2439 to show increases in the basis of your shares.

Reduction of basis. You must reduce your basis in your shares by any nondividend distributions that you receive from the fund.

The mutual fund reports the amount of any nondividend distributions on Form 1099-DIV, box 3. You should keep the form to show the decrease in the basis of your shares.

Basis cannot go below zero. Your basis cannot be reduced below zero. If your basis is zero, you must report the nondividend distribution on your tax return as a capital gain. Report this capital gain on Schedule D (Form 1040). Whether it is a long-term or short-term capital gain depends on how long you held the shares.

No reduction of basis. You do not reduce your basis for distributions from the fund that are exempt-interest dividends.

Table 2. This is a worksheet you can use to keep track of the adjusted basis of your mutual fund shares. Enter the cost per share when you acquire new shares and any adjustments to their basis when the adjustment occurs. This worksheet will help you figure the adjusted basis when you sell or redeem shares.

Sales, Exchanges, and Redemptions

When you sell or exchange your mutual fund shares, or if they are redeemed (a redemption), you will generally have a taxable gain or a deductible loss. This also applies to shares of a tax-exempt mutual fund. Sales, exchanges, and redemptions are all treated as sales of capital assets. The amount of the gain or loss is the difference between your adjusted basis (defined earlier) in the shares and the amount you realize from the sale, exchange, or redemption. This is explained further under *Gains and Losses*, later.

Sale. In general, a sale is a transfer of shares for money only.

Exchange. An exchange is a transfer of shares in return for other shares.

Redemption. A redemption occurs when a fund reacquires its shares from you in exchange for money or other property.

Recordkeeping. When there is a sale, exchange, or redemption of your shares in a fund, keep the confirmation statement you receive. The statement shows the price you received for the shares and other information you need to report gain or loss on your return.

Exchange of shares in one mutual fund for shares in another mutual fund. Any exchange of shares in one fund for shares in another fund is a taxable exchange. This is true even if you exchange shares in one fund for shares in another fund within the same family of funds. Report any gain or loss on the shares you gave up as a capital gain or loss in the year in which the exchange occurs. Usually, you can add any service charge or fee paid in connection with an exchange to the cost of the shares acquired. For an exception, see *Commissions and* *load charges* under *Shares Acquired by Purchase*, earlier.

Information returns. Mutual funds and brokers must report proceeds from sales, exchanges, or redemptions to the Internal Revenue Service. They must provide or send each customer a written statement with that information by February 15 of the year following the calendar year the transaction occurred. Form 1099-B, or a substitute, may be used for this purpose. If it is mailed, you should allow adequate time to receive it before contacting the payer. If you still do not get the form by February 28, call the IRS for help.

Report your sales shown on Form(s) 1099-B (or substitute) on Schedule D (Form 1040) along with your other gains and losses. If the total of the sales price amounts reported on Form(s) 1099-B in box 2 is more than the total you report on Schedule D (Form 1040), lines 3 and 10, attach a statement to your return explaining the difference.

Taxpayer identification number. You must give the broker your correct taxpayer identification number (TIN). Generally, an individual will use his or her social security number as the TIN.

If you do not provide your TIN, your broker is required to withhold tax on the gross proceeds of a transaction. For 2009, the withholding rate is 28%. In addition, you may be penalized.

Identifying the Shares Sold

To figure your gain or loss when you dispose of mutual fund shares, you need to determine which shares were sold and the basis of those shares. If your shares in a mutual fund were acquired all on the same day and for the same price, figuring their basis is not difficult. However, shares are generally acquired at various times, in various quantities, and at various prices. Therefore, figuring your basis can be more difficult. You can choose to use either a cost basis or an average basis to figure your gain or loss.

Cost Basis

You can figure your gain or loss using a cost basis only if you did not previously use an average basis for a sale, exchange, or redemption of other shares in the same mutual fund.

To figure cost basis, you can choose one of the following methods.

- Specific share identification.
- First-in first-out (FIFO).

Specific share identification. If you adequately identify the shares you sold, you can use the adjusted basis of those particular shares to figure your gain or loss.

You will adequately identify your mutual fund shares, even if you bought the shares in different lots at various prices and times, if you:

1. Specify to your broker or other agent the particular shares to be sold or transferred at the time of the sale or transfer, and
2. Receive confirmation in writing from your broker or other agent within a reasonable time of your specification of the particular shares sold or transferred.

You continue to have the burden of proving your basis in the specified shares at the time of sale or transfer.

First-in first-out (FIFO). If your shares were acquired at different times or at different prices and you cannot identify which shares you sold, use the basis of the shares you acquired first as the basis of the shares sold. In other words, the oldest shares you own are considered sold first. You should keep a separate record of each purchase and any dispositions of the shares until all shares purchased at the same time have been disposed of completely.

Table 3 (on the next page) illustrates the use of the FIFO method to figure the cost basis of shares sold, compared with the use of the single-category method to figure average basis (discussed next).

Table 2. **Mutual Fund Record**

Mutual Fund	Acquired[1]			Adjustment to Basis Per Share					Adjusted[2] Basis Per Share	Sold or redeemed	
	Date	Number of Shares	Cost Per Share							Date	Number of Shares

[1] Include share received from reinvestment of distributions.
[2] Cost plus or minus adjustments.

Table 3. **Example of How To Figure Basis of Shares Sold**

This is an example showing two different ways to figure basis. It compares the cost basis using the FIFO method with the average basis using the single-category method.

Date	Action	Share Price	No. of Shares	Total Shares Owned
2/6/07	Invest $4,000	$25	160	160
8/7/07	Invest $4,800	$20	240	400
12/18/07	Reinvest $300 dividend	$30	10	410
10/1/08	Sell 210 shares for $6,720	$32	210	200

COST BASIS (FIFO)

To figure the basis of the 210 shares sold on 10/1/08, use the share price of the first 210 shares you bought, namely the 160 shares you purchased on 2/6/07 and 50 of those purchased on 8/7/07.

$4,000 (cost of 160 shares on 2/6/07)
+ $1,000 (cost of 50 shares on 8/7/07)
Basis = $5,000

AVERAGE BASIS (single-category)

To figure the basis of the 210 shares sold on 10/1/08, use the average basis of all 410 shares owned on 10/1/08.

$9,100 (cost of 410 shares)
÷ 410 (number of shares)
$22.20 (average basis per share)

$22.20
× 210
Basis = $4,662

Average Basis

You can figure your gain or loss using an average basis only if you acquired the shares at various times and prices, and you left the shares on deposit in an account handled by a custodian or agent who acquires or redeems those shares.

To figure average basis, you can use one of the following methods.

- Single-category method.
- Double-category method.

Once you elect to use an average basis, you must continue to use it for all accounts in the same fund. (You must also continue to use the same method.) However, you may use the cost basis (or a different method of figuring the average basis) for shares in other funds, even those within the same family of funds.

Example. You own two accounts that hold shares of the income fund issued by Company A. You also own 100 shares of the growth fund issued by Company A. If you elect to use average basis for the first account of the income fund, you must use average basis for the second account. However, you may use cost basis for the growth fund.

TIP *You may be able to find the average basis of your shares from information provided by the fund.*

Single-category method. Under the single-category method, you find the average basis of all shares owned at the time of each disposition, regardless of how long you owned them. Include shares acquired with reinvested dividends or capital gain distributions.

Table 3 illustrates the use of the single-category method to figure the average basis of shares sold, compared with the use of the FIFO method to figure cost basis (discussed earlier).

Even though you include all unsold shares of a fund in a single category to compute average basis, you may have both short-term and long-term gains or losses when you sell these shares. To determine your holding period, the shares disposed of are considered to be those acquired first.

Example. You bought 400 shares in the LJO Mutual Fund: 200 shares on May 15, 2007, and 200 shares on May 14, 2008. On November 10, 2008, you sold 300 shares. The basis of all 300 shares sold is the same, but you held 200 shares for more than 1 year, so your gain or loss on those shares is long term. You held 100 shares for 1 year or less, so your gain or loss on those shares is short term.

How to figure the basis of shares sold. To figure the basis of shares you sell, use the steps in the following worksheet.

1) Enter the total adjusted basis of all the shares you owned in the fund just before the sale. (If you made an earlier sale of shares in this fund, add the adjusted basis of any shares you still owned after the last sale and the adjusted basis of any shares you acquired after that sale.) . . . . $____
2) Enter the total number of shares you owned in the fund just before the sale . . . . _____
3) Divide the amount on line 1 by the amount on line 2. This is your ***average basis per share*** . . . . . . $____
4) Enter the number of shares you sold . . . . _____
5) Multiply the amount on line 3 by the amount on line 4. This is the ***basis of the shares you sold*** . . . . $____

Example 1. You bought 300 shares in the LJP Mutual Fund: 100 shares in 2005 for $1,000 ($10 per share); 100 shares in 2006 for $1,200 ($12 per share); and 100 shares in 2007 for $2,600 ($26 per share). Thus, the total cost of your shares was $4,800 ($1,000 + $1,200 + $2,600). On May 16, 2008, you sold 150 shares. The basis of the shares you sold is $2,400 ($16 per share), figured as follows.

1) Enter the total adjusted basis of all the shares you owned in the fund just before the sale. (If you made an earlier sale of shares in this fund, add the adjusted basis of any shares you still owned after the last sale and the adjusted basis of any shares you acquired after that sale.) $4,800
2) Enter the total number of shares you owned in the fund just before the sale 300
3) Divide the amount on line 1 by the amount on line 2. This is your ***average basis per share*** . . . . . . $ 16
4) Enter the number of shares you sold 150
5) Multiply the amount on line 3 by the amount on line 4. This is the ***basis of the shares you sold*** . . . $2,400

Remaining shares. The average basis of the shares you still hold after a sale of some of your shares is the same as the average basis of the shares sold. The next time you make a sale, your average basis will still be the same, unless you have acquired additional shares (or have made a subsequent adjustment to basis).

Example 2. The facts are the same as in Example 1, except that you sold an additional 50 shares on December 17, 2008. You do not need to recompute the average basis of the 150 shares you owned at that time because you acquired or sold no shares, and had no other adjustments to basis, since the last sale. Your basis is the $16 per share figured earlier.

Example 3. The facts are the same as in Example 1, except that you bought an additional 150 shares at $14 a share on September 17, 2008, and then sold 50 shares on December 18, 2008. The total adjusted basis of all the shares you owned just before the sale is $4,500, figured as follows.

1) Basis of remaining shares ($16 x 150) $2,400
2) Cost of shares acquired 9/17/08 ($14 x 150) $2,100
3) Total adjusted basis of all shares owned ($2,400 + $2,100) $4,500

The basis of the shares sold is $750 ($15 a share), figured as follows.

1) Enter the total adjusted basis of all the shares you owned in the fund just before the sale. (If you made an earlier sale of shares in this fund, add the adjusted basis of any shares you still owned after the last sale and the adjusted basis of any shares you acquired after that sale.) $4,500
2) Enter the total number of shares you owned in the fund just before the sale 300
3) Divide the amount on line 1 by the amount on line 2. This is your ***average basis per share*** . . . . . . $ 15
4) Enter the number of shares you sold 50
5) Multiply the amount on line 3 by the amount on line 4. This is the ***basis of the shares you sold*** . . . $ 750

Double-category method. In the double-category method, all shares in an account at the time of each disposition are divided into two categories: short term and long term. Shares held 1 year or less are short term. Shares held longer than 1 year are long term.

The basis of each share in a category is the average basis for that category. This is the total remaining basis of all shares in that category at the time of disposition divided by the total shares in the category at that time. To use this method, you specify, to the custodian or agent handling your account, from which category the shares are to be sold or transferred. The custodian or agent must confirm in writing your specification. If you do not specify or receive confirmation, you must first charge the shares sold against the long-term category and then charge any remaining shares sold against the short-term category.

Changing categories. After you have held a mutual fund share for more than 1 year, you must transfer that share from the short-term category to the long-term category. The basis of a transferred share is its actual cost or other basis to you unless some of the shares in the short-term category have been disposed of. In that case, the basis of a transferred share is the average basis of the undisposed shares at the time of the most recent disposition from this category.

Making the choice. You choose to use the average basis of mutual fund shares by clearly showing on your income tax return, for each year the choice applies, that you used an average basis in reporting gain or loss from the sale or transfer of the shares. You must specify whether you used the single-category method or the double-category method in determining average basis. This choice is effective until you get permission from the IRS to revoke it.

Shares received as gift. If your account includes shares that you received by gift, and the fair market value of the shares at the time of the gift was not more than the donor's basis, special rules apply. You cannot choose to use the average basis for the account unless you submit a statement with your initial choice. It must state that the basis used in figuring the average basis of the gift shares will be the FMV at the time of the gift. This statement applies to gift shares received before and after making the choice, as long as the choice to use the average basis is in effect.

Gains and Losses

You figure gain or loss on the disposition of your shares by comparing the amount you realize with the adjusted basis of your shares. If the amount you realize is more than the adjusted basis of the shares, you have a gain. If the amount you realize is less than the adjusted basis of the shares, you have a loss.

Amount you realize. The amount you realize from a disposition of your shares is the money and value of any property you receive for the shares disposed of, minus your expenses of sale (such as redemption fees, sales commissions, sales charges, or exit fees).

Adjusted basis. Adjusted basis is explained under *Keeping Track of Your Basis*, earlier. Also see the explanations of cost basis and average basis under *Identifying the Shares Sold*, earlier.

Wash sales. If you sell mutual fund shares at a loss and within 30 days before or after the sale you buy, acquire in a taxable exchange, or acquire a contract or option to buy substantially identical shares, you have a wash sale. You cannot deduct losses from wash sales.

Substantially identical. In determining whether the shares are substantially identical, you must consider all the facts and circumstances. Ordinarily, shares issued by one mutual fund are not considered to be substantially identical to shares issued by another mutual fund.

For more information on wash sales, see Publication 550.

Reporting information from Form 1099-B. Mutual funds and brokers report dispositions of mutual fund shares on Form 1099-B, or a substitute form containing substantially the same language. The form shows the amount of the sales price and indicates whether the amount reported is the gross amount or the net amount (gross amount minus commissions).

If your Form 1099-B or similar statement from the payer shows the gross sales price, do not subtract the expenses of sale from it when reporting your sales price in column (d) on Schedule D (Form 1040). Instead, report the gross amount in column (d) and increase your cost or other basis, column (e), by any expense of the sale. If your Form 1099-B shows that the gross sales price less commissions was reported to IRS, enter the net amount in column (d) of Schedule D (Form 1040) and do not increase your basis in column (e) by the sales commission.

Example 1. You sold 100 shares of Fund HIJ for $2,500. You paid a $75 commission to the broker for handling the sale. Your Form 1099-B shows that the net sales proceeds, $2,425 ($2,500 – $75), were reported to the IRS. Report $2,425 in column (d) of Schedule D (Form 1040).

Example 2. You sold 200 shares of Fund KLM for $10,000. You paid a $100 commission at the time of the sale. You bought the shares for $5,000. The broker reported the gross proceeds to IRS on Form 1099-B, so you enter $10,000 in column (d) of Schedule D (Form 1040) and increase your basis in column (e) to $5,100.

Note. Whether you use line 1 (for a short-term gain or loss) or line 8 (for a long-term gain or loss) of Schedule D (Form 1040) depends on how long you held the shares, discussed next.

Holding Period

When you dispose of your mutual fund shares, you must determine your holding period. Your holding period determines whether the gain or loss is a short-term capital gain or loss or a long-term capital gain or loss.

Short-term gain or loss. If you hold the shares for 1 year or less, your gain or loss will be a short-term gain or loss.

Long-term gain or loss. If you hold the shares for more than 1 year, your gain or loss will be a long-term gain or loss.

Determining period held. Determine your holding period by using the trade dates of your purchases and your sales. The trade date is the date on which you contract to buy or sell shares. Most mutual funds will show the trade dates on confirmation statements showing your purchases and sales.

CAUTION *Do not confuse the trade date with the settlement date, which is the date by which the mutual fund shares must be delivered and payment must be made.*

To find out how long you have held your shares, begin counting on the day after the trade date on which you bought the shares. (Do not count the trade date itself.) The trade date on which you dispose of the shares is counted as part of your holding period.

Example. If you bought shares on January 3, 2007 (trade date), and sold them on January 3, 2008 (trade date), your holding period would not be more than 1 year. If you sold them on January 4, 2008, your holding period would be more than 1 year (12 months plus 1 day).

Mutual fund shares received as a gift. If you receive a gift of mutual fund shares and your basis is determined by the donor's basis, your holding period is considered to have started on the same day that the donor's holding period started.

Inherited mutual fund shares. If you inherit mutual fund shares, you are considered to have held the shares for more than 1 year, regardless of how long you actually held them. Report the sale of inherited mutual fund shares on Schedule D (Form 1040), line 8, and enter "Inherited" in column (b) instead of the date you acquired the shares.

Reinvested distributions. If your dividends and capital gain distributions are reinvested in new shares, the holding period of each new share begins the day after that share was purchased. Therefore, if you sell both the new shares and the original shares, you might have both short-term and long-term gains and losses.

Certain short-term losses. Special rules may apply if you have a short-term loss on the sale of shares on which you received an exempt-interest dividend or a capital gain distribution.

Exempt-interest dividends before short-term loss. If you received exempt-interest dividends on mutual fund shares that you held for 6 months or less and sold at a loss, you may claim only the part of the loss that is more than the exempt-interest dividends. On Schedule D (Form 1040), column (d), increase the sales price by the amount of exempt-interest dividends, but do not increase it to more than the cost or other basis shown in column (e). Report the loss as a short-term capital loss.

Example. On January 7, 2008, you bought a mutual fund share for $40. On February 4, 2008, the mutual fund paid a $5 dividend from tax-exempt interest, which is not taxable to you. On February 11, 2008, you sold the share for $34. If it were not for the tax-exempt dividend, your loss would be $6 ($40 − $34). However, you must increase the sales price from $34 to $39 (to account for the $5 portion of the loss that is not deductible). You can deduct only $1 as a short-term capital loss.

Capital gain distribution before short-term loss. Generally, if you received capital gain distributions (or had to report undistributed capital gains) on mutual fund shares that you held for 6 months or less and sold at a loss, report only the part of the loss that is more than the capital gain distribution (or undistributed capital gain) as a short-term capital loss. The rest of the loss is reported as a long-term capital loss.

Example. On April 10, 2008, you bought a mutual fund share for $20. On June 26, 2008, the mutual fund paid a capital gain distribution of $2 a share, which is taxed as a long-term capital gain. On July 14, 2008, you sold the share for $17.50. If it were not for the capital gain distribution, your loss would be a short-term loss of $2.50 ($20 − $17.50). However, the part of the loss that is not more than the capital gain distribution ($2) must be reported as a long-term capital loss. The remaining $0.50 of the loss can be reported as a short-term capital loss.

Loss on share that paid qualified dividends. Any loss on the sale or exchange of a mutual fund share must be treated as a long-term capital loss to the extent you received, from that share, qualified dividends (defined earlier) that are extraordinary dividends. This is true regardless of how long you actually held the share. Generally, an extraordinary dividend is a dividend that equals or exceeds 10% (5% in the case of preferred stock) of your adjusted basis in the mutual fund share.

How To Figure Net Gain or Loss

Separate your short-term gains and losses from your long-term gains and losses on all the mutual fund shares and other capital assets you disposed of during the year. Then determine your net short-term gain or loss and your net long-term gain or loss.

Net short-term capital gain or loss. Net short-term capital gain or loss is determined by adding the gains and losses shown on Schedule D (Form 1040), Part I, column (f), lines 1 through 6. Line 7 is the net short-term capital gain or loss.

Net long-term capital gain or loss. Net long-term capital gain or loss is determined by adding the gains and losses shown on Schedule D (Form 1040), Part II, column (f), lines 8 through 14. Line 15 is the net long-term capital gain or loss.

Your net long-term capital gain or loss includes any undistributed capital gains you reported on Schedule D (Form 1040), line 11, and any capital gain distributions you reported on Schedule D (Form 1040), line 13.

Total net gain or loss. The total net gain or loss is determined by combining the net short-term capital gain or loss on line 7 with the net long-term capital gain or loss on line 15. Enter the result on Schedule D (Form 1040), Part III, line 16. If line 16 shows a gain, enter the amount on Form 1040, line 13. If line 16 shows a loss, see *Limit on Capital Loss Deduction*, later.

Figuring Your Tax

If you are reporting capital gain distributions on Form 1040A, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040A instructions to figure your tax. See *How To Report*, earlier, to see whether you can report your capital gain distributions on Form 1040A.

If you are reporting capital gain distributions on Form 1040, but are not required to file Schedule D (Form 1040), use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions to figure your tax. See *How To Report*, earlier, to see whether you must file Schedule D (Form 1040).

If you are required to file Schedule D (Form 1040), use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions to figure your tax if both of the following are true.

1. You have a net capital gain or qualified dividends (or both). You have a net capital gain if both lines 15 and 16 of Schedule D (Form 1040) are gains. Qualified dividends are explained earlier under *Tax Treatment of Distributions*.
2. You do not have to use the Schedule D Tax Worksheet.

If you have any collectibles gain, exclusion from eligible gain on qualified small business stock, or unrecaptured section 1250 gain, you will have to use the Schedule D Tax Worksheet in the Schedule D instructions to figure your tax.

Capital Gain Tax Rates

The tax rates that apply to a net capital gain are generally lower than the tax rates that apply to other income. These lower rates are called the maximum capital gain rates.

The term "net capital gain" means the amount by which your net long-term capital gain for the year is more than any net short-term capital loss.

The maximum capital gain rate can be 0%, 15%, 25%, or 28%. See Table 4.

TIP *If you figure your tax using the maximum capital gain rate and the regular tax computation results in a lower tax, the regular tax computation applies.*

Example. You have a capital gain distribution that is a section 1202 gain, so the maximum capital gain rate on the distribution would be 28%. Because you are single and your taxable income is $25,000, none of your taxable income will be taxed above the 15% rate. The 28% rate does not apply.

Limit on Capital Loss Deduction

If Schedule D (Form 1040), Part III, line 16, shows a loss, your allowable capital loss deduction is the smaller of:

1. $3,000 ($1,500 if you are married and filing a separate return), or
2. Your total net loss shown on Schedule D (Form 1040), line 16.

Enter your allowable loss on Form 1040, line 13.

Example. Bob and Gloria sold all of their shares in a mutual fund. The sale resulted in a capital loss of $7,000. They had no other capital transactions. Their taxable income was $26,000. On their joint 2008 return, they can deduct $3,000. The unused part of the loss, $4,000 ($7,000 − $3,000), can be carried over to 2009.

If Bob and Gloria's capital loss had been $2,000, their capital loss deduction would have been $2,000. They would have no carryover.

Capital loss carryover. If you have a total net loss on Schedule D (Form 1040), line 16, that is more than the yearly limit on capital loss deductions, you can carry over the unused part to next year and treat it as if you had incurred it in that next year. To determine your capital loss carryover, subtract from your total net loss the lesser of:

1. Your allowable capital loss deduction for the year, or
2. Your taxable income increased by your allowable capital loss deduction for the year and by your deduction for personal exemptions.

If your deductions exceed your gross income, you start the computation in (2) above with a negative number.

Use the Capital Loss Carryover Worksheet in Publication 550 to figure your capital loss carryover.

When carried over, the loss will keep its original character as long term or short term. Therefore, a long-term capital loss carried over from a previous year will offset long-term gains of the current year before it offsets short-term gains of the current year. For more information on figuring capital loss carryovers, see Publication 550.

Separate returns. Capital loss carryovers from separate returns are combined if you now file a joint return. However, if you once filed jointly and are now filing separately, a capital loss carryover from the joint return can be deducted only on the separate return of the spouse who actually had the loss.

Investment Expenses

You can generally deduct the expenses of producing taxable investment income. These include expenses for investment counseling and advice, legal and accounting fees, and investment newsletters. These expenses are deductible as miscellaneous itemized deductions to the extent that they exceed 2% of your adjusted gross income. See chapter 3 in Publication 550 for more information.

Interest paid on money to buy or carry investment property is also deductible, but the deduction may be limited. See *Limit on Investment Interest Expense,* later.

Publicly offered mutual funds. Most mutual funds are publicly offered. Expenses of publicly offered mutual funds are not treated as miscellaneous itemized deductions. This is because these mutual funds report only the net amount of investment income after your share of the investment expenses has been deducted.

Nonpublicly offered mutual funds. If you own shares in a nonpublicly offered mutual fund during the year, you can deduct your share of the investment expenses on your Schedule A

Table 4. **What Is Your Maximum Capital Gain Rate?**

IF your net capital gain is from ...	THEN your maximum capital gain rate is ...
collectibles gain	**28%**
eligible gain on qualified small business stock minus the section 1202 exclusion	**28%**
unrecaptured section 1250 gain	**25%**
other gain*, and the regular tax rate that would apply is 25% or higher	**15%**
Other gain*, and the regular tax rate that would apply is lower than 25%	**0%**

* "Other gain" means any gain that is not collectibles gain, eligible gain on qualified small business stock, or unrecaptured section 1250 gain.

(Form 1040). Claim them as a miscellaneous itemized deduction to the extent your miscellaneous itemized deductions exceed 2% of your adjusted gross income. Your share of the expenses will be shown in box 5 of Form 1099-DIV. A nonpublicly offered mutual fund is one that:

1. Is not continuously offered pursuant to a public offering,
2. Is not regularly traded on an established securities market, and
3. Is held by fewer than 500 persons at any time during the tax year.

Contact your mutual fund if you are not sure whether it is nonpublicly offered.

Expenses allocable to exempt-interest dividends. You cannot deduct expenses that are for the collection or production of exempt-interest dividends. Expenses must be allocated if they were for both taxable and tax-exempt income. One accepted method for allocating expenses is to divide them in the same proportion that each type of income from the mutual fund is to your total income from the fund. To find the part of the expenses that relates to the tax-exempt income, you must first divide your tax-exempt income by your total income. Then multiply your expenses by the result. You cannot deduct this part.

Example. William received $600 in dividends from his mutual fund: exempt-interest dividends of $480 and taxable dividends of $120. In earning this income, he had a $50 expense for a newsletter on mutual funds. William divides the exempt-interest dividends by the total dividends to figure the part of the expense that is not deductible. Therefore, 80% ($480 ÷ $600) of William's expense is for exempt-interest income. He cannot deduct $40 (80% of $50) of the expense. William may claim the balance of the expense, $10, as a miscellaneous itemized deduction subject to the 2%-of-adjusted-gross-income limit. That is the part of the expense allocable to the taxable dividends.

Limit on Investment Interest Expense

The amount you can deduct as investment interest expense may be limited in two different ways. First, you may not deduct the interest on money you borrow to buy or carry shares in a mutual fund that distributes only exempt-interest dividends. If the fund also distributes taxable dividends, you must allocate the interest between the taxable and nontaxable income. Allocate the interest as explained under *Expenses allocable to exempt-interest dividends*, earlier.

Second, your deduction for investment interest expense is limited to the amount of your net investment income.

Net investment income. This is figured by subtracting your investment expenses other than interest from your investment income. For this purpose, do not include any income or expenses taken into account to figure gain or loss from passive activities. For more information on passive activity losses, see Publication 925, Passive Activity and At-Risk Rules.

Investment income. Investment income generally includes gross income derived from property held for investment (such as interest, dividends, annuities, and royalties). It generally does not include net capital gain derived from disposing of investment property. Nor does it include qualified dividends or capital gain distributions from mutual fund shares. However, you can choose to include part or all of these amounts in investment income. For information on this choice, see chapter 3 of Publication 550.

Investment expenses. Investment expenses are your allowed deductions (other than interest expense) directly connected with the production of investment income. Investment expenses that are included as a miscellaneous itemized deduction on Schedule A (Form 1040) are allowable deductions after subtracting 2% of adjusted gross income. In figuring the amount over the 2% limit, miscellaneous expenses that are not investment expenses are disallowed before any investment expenses are disallowed.

For information on the 2% limit, see Publication 529, Miscellaneous Deductions.

Example. Jane, a single taxpayer, has investment income for the year of $12,000. Jane's investment expenses (other than interest expense) directly connected with the production of income were $980 after subtracting the 2% limit on miscellaneous itemized deductions. Jane incurred $12,500 of investment interest expense during the year. She had no passive activity losses. Jane figures net investment income and the limit on her investment interest expense deduction as follows:

Total investment income	$12,000
Subtract: Investment expenses (other than interest)	−980
Net investment income	$11,020

For the year, Jane's investment interest expense deduction is limited to $11,020 (her net investment income). The disallowed interest expense of $1,480 ($12,500 − $11,020) can be carried forward to the following year as explained next under *Carryover.*

Carryover. You can carry forward to the next tax year the investment interest that you cannot deduct because of the limit. You can deduct the interest carried forward to the extent that your net investment income exceeds your investment interest in that later year.

Form 4952. Use Form 4952 to figure your investment interest expense deduction. For more information about investment interest expense, see Publication 550.

Comprehensive Example

Robert and Janice Martin have the following four sources of investment income to report on their 2008 tax return. Page 1 of their Schedule D (Form 1040) is shown later. Page 2 is not illustrated.

1. $1,204 gain from the sale of 200 shares of Mutual Fund S on October 10, 2008. They received Form 1099-B, and they report the sale on Schedule D (Form 1040).

   Robert and Janice purchased these shares in 1994 at $10 each. They received some nondividend distributions in 1996, 1997, and 2005 that reduced their basis in the shares. In 2006 and 2007, the Martins reported undistributed capital gains that increased their basis in their shares. They received no distributions in 2008 before the sale.

2. $265 of ordinary dividends, including $250 of qualified dividends, and $61 of capital gain distributions from Mutual Fund R. The Martins received Form 1099-DIV showing these amounts. They report the ordinary dividends on Form 1040, line 9a. They report the qualified dividends on Form 1040, line 9b. They do not report the ordinary dividends on Schedule B (Form 1040) because their total ordinary dividends were not over $1,500. They report the capital gain distributions on Schedule D (Form 1040) because they have other capital transactions.

   Robert and Janice invested $3,800 in this fund in June 2008 and received 153.16 shares that cost $24.81 per share. They requested that all of their distributions be reinvested in more shares of the fund. On

December 29, 2008, they acquired an additional 13.03 shares at $25.01 per share from their reinvested dividends.

3. $101 of exempt-interest dividends from Mutual Fund X. They chose not to reinvest these exempt-interest dividends and instead received a cash payment. They received a Form 1099-INT from the fund showing this nontaxable amount, which they report on Form 1040, line 8b.

   The Martins invested $2,600 in this fund in April 2006 and received 87.54 shares at $29.70 per share. They received exempt-interest dividends of $92 in 2006 and $107 in 2007.

4. $237 in ordinary dividends, including $220 of qualified dividends, from 100 shares of common stock in Green Publishing Company. These were received as a cash payment and not reinvested. They received Form 1099-DIV, and they report the ordinary dividends on Form 1040, line 9a, and the qualified dividends on Form 1040, line 9b.

   Robert and Janice bought this stock in 1994 for $10.29 per share.

Mutual Fund Record. Robert and Janice keep track of all their basis adjustments on their Mutual Fund Record, shown later. They show the nondividend distributions and the undistributed capital gains from Mutual Fund S and the reinvested dividends from Mutual Fund R. They do not show the exempt-interest dividends from Mutual Fund X because those dividends do not change their basis in the shares.

The Martins keep this record with their mutual fund documents, and they use it to report their 2008 sale of Mutual Fund S.

Preparing Schedule D (Form 1040). The Martins use their Form 1099-B and their Mutual Fund Record to figure the gain from the sale of Mutual Fund S to report on Schedule D (Form 1040).

Robert and Janice enter the $61 capital gain distribution from Mutual Fund R (from Form 1099-DIV, box 2a) on line 13, column (f).

They report the sale of their shares in Mutual Fund S on line 8 because they owned the shares for more than 1 year. They use the information from their Mutual Fund Record to complete columns (a), (b), and (e). After adjustment for their nondividend distributions and their undistributed capital gains, their basis is $1,996 ($9.98 per share). They use their Form 1099-B to complete columns (c) and (d). Their sales price in column (d) (the gross proceeds from Form 1099-B, box 2) is $3,200 ($16 per share). They enter their gain of $1,204 in column (f).

Robert and Janice add the amounts in column (f) of lines 8 and 13 and enter their net long-term capital gain of $1,265 on line 15. They also enter that amount on line 16. They check the “Yes” box for line 17, leave lines 18 and 19 blank, and check the “Yes” box for line 20. They follow the line 20 instructions and they compute their tax on Form 1040 using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions. They enter their taxable income of $36,505 (from Form 1040, line 43) on line 1 of the worksheet and their qualified dividends of $470 ($250 from Mutual Fund R and $220 from Green Publishing Co.) (from Form 1040, line 9b) on line 2.

Table 5. **Mutual Fund Record for Robert and Janice Martin**

Mutual Fund	Acquired[1]			Adjustment to Basis Per Share					Adjusted[2] Basis Per Share	Sold or Redeemed	
	Date	Number of Shares	Cost Per Share							Date	Number of Shares
MUTUAL FUND S	7-12-94	200	10.00	12-31-96 (.05)	12-31-97 (.02)	12-31-05 (.04)	12-31-06 .03	8-29-07 .06	9.98	10-10-08	200
MUTUAL FUND X	4-19-06	87.54	29.70								
MUTUAL FUND R	6-12-08	153.16	24.81								
	12-29-08	13.03	25.01								

[1] Include share received from reinvestment of distributions.
[2] Cost plus or minus adjustments.

Filled-in Schedule D—Robert and Janice Martin
(Page references are to the Schedule D instructions.)

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Capital Gains and Losses

► Attach to Form 1040 or Form 1040NR. ► See Instructions for Schedule D (Form 1040).
► Use Schedule D-1 to list additional transactions for lines 1 and 8.

OMB No. 1545-0074
2008
Attachment Sequence No. 12

Name(s) shown on return: ROBERT A. and JANICE MARTIN

Your social security number: 123 00 4567

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

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-7 of the instructions)	(e) Cost or other basis (see page D-7 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2			2		
3	**Total short-term sales price amounts.** Add lines 1 and 2 in column (d)			3		

4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions	6	( )
7	**Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (f)	7	

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

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-7 of the instructions)	(e) Cost or other basis (see page D-7 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)
8	200 Shares MUTUAL FUND S	7-12-94	10-10-08	3,200	1,996	1,204
9	Enter your long-term totals, if any, from Schedule D-1, line 9			9		
10	**Total long-term sales price amounts.** Add lines 8 and 9 in column (d)			10 3,200		

11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13	Capital gain distributions. See page D-2 of the instructions	13	61
14	Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions	14	( )
15	**Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f). Then go to Part III on the back	15	1,265

For Paperwork Reduction Act Notice, see Form 1040 or Form 1040NR instructions. Cat. No. 11338H **Schedule D (Form 1040) 2008**

Qualified Dividends and Capital Gain Tax Worksheet—Line 44

Keep for Your Records

Before you begin:
√ See the instructions for line 44 that begin on page 36 to see if you can use this worksheet to figure your tax.
√ If you do not have to file Schedule D and you received capital gain distributions, be sure you checked the box on line 13 of Form 1040.

1.	Enter the amount from Form 1040, line 43. However, if you are filing Form 2555 or Form 2555-EZ (relating to foreign earned income), enter the amount from line 3 of the worksheet on page 37		**1.** 36,505		
2.	Enter the amount from Form 1040, line 9b*	**2.** 470			
3.	Are you filing Schedule D?* ☑ **Yes.** Enter the **smaller** of line 15 or 16 of Schedule D. If either line 15 or line 16 is a loss, enter -0- ☐ **No.** Enter the amount from Form 1040, line 13	**3.** 1,265			
4.	Add lines 2 and 3	**4.** 1,735			
5.	If you are claiming investment interest expense on Form 4952, enter the amount from line 4g of that form. Otherwise, enter -0-	**5.** -0-			
6.	Subtract line 5 from line 4. If zero or less, enter -0-		**6.** 1,735		
7.	Subtract line 6 from line 1. If zero or less, enter -0-		**7.** 34,770		
8.	Enter the **smaller** of: • The amount on line 1, or • $32,550 if single or married filing separately, $65,100 if married filing jointly or qualifying widow(er), $43,650 if head of household.		**8.** 36,505		
9.	Is the amount on line 7 equal to or more than the amount on line 8? ☐ **Yes.** Skip lines 9 and 10; go to line 11 and check the "No" box. ☑ **No.** Enter the amount from line 7		**9.** 34,770		
10.	Subtract line 9 from line 8		**10.** 1,735		
11.	Are the amounts on lines 6 and 10 the same? ☑ **Yes.** Skip lines 11 through 14; go to line 15. ☐ **No.** Enter the **smaller** of line 1 or line 6		**11.**		
12.	Enter the amount from line 10 (if line 10 is blank, enter -0-)		**12.**		
13.	Subtract line 12 from line 11		**13.**		
14.	Multiply line 13 by 15% (.15)			**14.**	
15.	Figure the tax on the amount on line 7. Use the Tax Table or Tax Computation Worksheet, whichever applies			**15.**	4,414
16.	Add lines 14 and 15			**16.**	4,414
17.	Figure the tax on the amount on line 1. Use the Tax Table or Tax Computation Worksheet, whichever applies			**17.**	4,676
18.	**Tax on all taxable income.** Enter the **smaller** of line 16 or line 17. Also include this amount on Form 1040, line 44. If you are filing Form 2255 or 2555-EZ, do not enter this amount on Form 1040, line 44. Instead, enter it on line 4 of the worksheet on page 37			**18.**	4,414

**If you are filing Form 2555 or Form 2555-EZ, see the footnote in the worksheet on page 37 before completing this line.*

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should.

You can contact the TAS by calling the TAS toll-free case intake line at 1-877-777-4778 or TTY/TDD 1-800-829-4059 to see if you are eligible for assistance. You can also call or write your local taxpayer advocate, whose phone number and address are listed in your local telephone directory and in Publication 1546, Taxpayer Advocate Service—Your Voice at the IRS. You can file Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order), or ask an IRS employee to complete it on your behalf. For more information, go to www.irs.gov/advocate.

Low Income Taxpayer Clinics (LITCs). LITCs are independent organizations that provide low income taxpayers with representation in federal tax controversies with the IRS for free or for a nominal charge. The clinics also provide tax education and outreach for taxpayers who speak English as a second language. Publication 4134, Low Income Taxpayer Clinic List, provides information on clinics in your area. It is available at www.irs.gov or your local IRS office.

Free tax services. To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains lists of free tax information sources, including publications, services, and free tax education and assistance programs. It also has an index of over 100 TeleTax topics (recorded tax information) you can listen to on your telephone.

Accessible versions of IRS published products are available on request in a variety of alternative formats for people with disabilities.

Free help with your return. Free help in preparing your return is available nationwide from IRS-trained volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low-income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Many VITA sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. To find the nearest VITA or TCE site, call 1-800-829-1040.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, call 1-888-227-7669 or visit AARP's website at www.aarp.org/money/taxaide.

For more information on these programs, go to www.irs.gov and enter keyword "VITA" in the upper right-hand corner.

Internet. You can access the IRS website at www.irs.gov 24 hours a day, 7 days a week to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2008 refund. Go to www.irs.gov and click on *Where's My Refund*. Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2008 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the withholding calculator online at www.irs.gov/individuals.
- Determine if Form 6251 must be filed by using our Alternative Minimum Tax (AMT) Assistant.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications, and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service.*
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* To check the status of your 2008 refund, call 1-800-829-1954 during business hours or 1-800-829-4477 (automated refund information 24 hours a day, 7 days a week). Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2008 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund. Refunds are sent out weekly on Fridays. If you check the status of your refund and are not given the date it will be issued, please wait until the next week before checking back.
- *Other refund information.* To check the status of a prior year refund or amended return refund, call 1-800-829-1954.

Evaluating the quality of our telephone services. To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you are more comfortable talking with someone in person, visit your local Taxpayer Assistance Center where you can spread out your records and talk with an IRS representative face-to-face. No appointment is necessary—just walk in. If you prefer, you can call your local Center and leave a message requesting an appointment to resolve a tax account issue. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. If you have an ongoing, complex tax account problem or a special need, such as a disability, an appointment can be requested. All other issues will be handled without an appointment. To find the number of your local office, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service.*

Mail. You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 days after your request is received.

Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, IL 61705-6613

DVD for tax products. You can order Publication 1796, IRS Tax Products DVD, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions.
- Tax Topics from the IRS telephone response system.
- Internal Revenue Code—Title 26 of the U.S. Code.
- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-free and email technical support.
- Two releases during the year.
  – The first release will ship the beginning of January 2009.
  – The final release will ship the beginning of March 2009.

Purchase the DVD from National Technical Information Service (NTIS) at www.irs.gov/cdorders for $30 (no handling fee) or call 1-877-233-6767 toll free to buy the DVD for $30 (plus a $6 handling fee). The price is discounted to $25 for orders placed prior to December 1, 2008.

Small Business Resource Guide 2009. This online guide is a must for every small business owner or any taxpayer about to start a business. This year's guide includes:

- Helpful information, such as how to prepare a business plan, find financing for your business, and much more.
- All the business tax forms, instructions, and publications needed to successfully manage a business.
- Tax law changes for 2009.
- Tax Map: an electronic research tool and finding aid.
- Web links to various government agencies, business associations, and IRS organizations.
- "Rate the Product" survey—your opportunity to suggest changes for future editions.
- A site map of the guide to help you navigate the pages with ease.
- An interactive "Teens in Biz" module that gives practical tips for teens about starting their own business, creating a business plan, and filing taxes.

The information is updated during the year. Visit www.irs.gov and enter keyword "SBRG" in the upper right-hand corner for more information.

Index

To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

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