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Mutual Fund Distributions

For use in preparing

1995 Returns

Contents

Important Change

Capital gains and losses. As this publication was being prepared for print, Congress was considering tax law changes that would affect your 1995 tax return and 1996 estimated taxes. These changes would affect the way you figure gains and losses from the sale of mutual fund shares. See Publication 553, *Highlights of 1995 Tax Changes*, for further developments.

Introduction

This publication explains the federal income tax treatment of distributions paid or allocated to an individual shareholder of a 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.

This publication provides information on investment expenses and will help you figure your taxable gain or deductible loss when you sell, exchange, or redeem your mutual fund shares. It discusses how to report your mutual fund distributions on Schedule B, *Interest and Dividend Income*, Schedule D, *Capital Gains and Losses*, and Form 1040. It also provides a comprehensive filled-in example.

The rules in this publication also apply to money market funds. A **money market fund** is a mutual fund that tries to increase current income available to shareholders by purchasing short-term market investments. Usually, dividends are declared and reinvested daily. When you dispose of your shares, the proceeds generally equal your investment in the fund because the value of the shares generally does not change. Money market funds pay dividends and should not be confused with bank money market accounts that pay interest.

Qualified employee plans. Individuals may own mutual funds as a part of an **individual retirement arrangement (IRA)**. Self-employed persons and partners may own mutual funds as a part of a **simplified employee pension (SEP) plan** or an **H.R 10 (Keogh) plan**. Distributions from these mutual funds are treated differently and are not discussed in this publication. Get Publication 590 for information concerning the treatment of IRA contributions and distributions and Publication 560 for information on retirement plans for the self-employed.

Useful Items

You may want to see:

Publication

- ☐ **514** Foreign Tax Credit for Individuals
- ☐ **550** Investment Income and Expenses
- ☐ **551** Basis of Assets
- ☐ **560** Retirement Plans for the Self-Employed
- ☐ **590** Individual Retirement Arrangements (IRAs)

Form (and Instructions)

- ☐ **1099–B** Proceeds from Broker and Barter Exchange Transactions
- ☐ **1099–DIV** Dividends and Distributions
- ☐ **1116** Foreign Tax Credit
- ☐ **2439** Notice to Shareholder of Undistributed Long-Term Capital Gains
- ☐ **4952** Investment Interest Expense Deduction

Ordering publications and forms. To order free publications and forms, call 1–800–TAX–FORM (1–800–829–3676). If you have access to TDD equipment, you can call 1–800–829–4059. See your tax package for the hours of operation. You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address.

If you have access to a personal computer and a modem, you can also get many forms and publications electronically. See *How To Get Forms and Publications* in your income tax package for details.

Asking tax questions. You can call the IRS with your tax question Monday through Friday during regular business hours. Check your telephone book or your tax package for the local number or you can call 1–800–829–1040 (1–800–829–4059 for TDD users).

Tax Treatment of Distributions

A mutual fund will send you a Form 1099–DIV, *Dividends and Distributions*, or a substitute form containing substantially the same language, to tell you what you must report or take into account on your income tax return. See *How To Report*, later.

Community property states. If you are married and receive dividend income that is community income, one-half of the income is generally considered to be received by each spouse. If you file separate returns, you must each report one-half of the dividend.

If the dividends are not considered community income under state law and you and your spouse file separate returns, each of you must report your separate income.

However, if you and your spouse lived apart all year, special rules may apply. Get Publication 555, *Federal Tax Information on Community Property*, for more information on community income.

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, dividends 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 that year if the dividends are actually paid during January of the following year.

Kinds of Distributions

There are several kinds of distributions that you, as a shareholder, may receive from a mutual fund. They include:

- Ordinary dividends,
- Capital gain distributions,
- Exempt-interest dividends, and
- Return of capital (nontaxable) distributions.

Tax-exempt mutual fund. A tax-exempt mutual fund (one that invests primarily in tax-exempt securities) may pay ordinary dividends, capital gain distributions, exempt-interest dividends, undistributed capital gains, or return of capital like any other mutual fund. If the fund pays you exempt-interest dividends, you are not taxed on those dividends (see *Exempt-Interest Dividends*, later).

All other distributions generally follow the same rules as a regular mutual fund. Regardless of what type of mutual fund you have (whether regular or tax-exempt), when you dispose of your shares (sell, exchange, or redeem), you usually will have a taxable gain or a deductible loss to report. See *Sales, Exchanges, and Redemptions*, 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 1b of Form 1099–DIV. If you reinvested your dividends, see *Reinvestment of Distributions*, later.

Capital Gain Distributions

These distributions are paid by mutual funds from their net realized long-term capital gains. The Form 1099–DIV (box 1c) or the fund's statement will tell you the amount you are to report as a capital gain distribution. Report capital gain distributions as long-term capital gains on your return regardless of how long you have owned the shares in the mutual fund. However, if you received a capital gain distribution on mutual fund shares that you held for 6 months or less **and sold at a loss**, see *Certain short-term losses* under *Holding Period*.

Undistributed capital gains. Some mutual funds keep their long-term capital gains and pay taxes on those amounts. You must report as long-term capital gains any amounts that the mutual fund allocated to you as capital gain distributions, even if you did not actually receive them.

Form 2439. The fund will send you Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*, showing your share of the undistributed capital gains and any tax paid by the mutual fund. You can take a credit for any tax paid because you are considered to have paid it. Take this credit by checking box a on line 60, Form 1040, and entering the tax shown on line 2 of Form 2439. Attach Copy B of Form 2439 to your return.

The undistributed capital gain reported on Form 2439 should be reported as a capital gain distribution in addition to any other capital gain distributions reported on Form 1099–DIV.

Increase to basis. When a mutual fund allocates undistributed capital gains to you, you can increase your basis in the shares. See *Additions to 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, you do not include them in income, but you may need to report them on your return. See *Information reporting requirement*, next. The mutual fund will send you a statement within 60 days after the close of its tax year showing your exempt-interest dividends. Exempt-interest dividends are not shown on Form 1099–DIV. However, if you received exempt-interest dividends on mutual fund shares that you held for 6 months or less **and sold at a loss**, see *Certain short-term losses* under *Holding Period*, later.

Information reporting requirement. If you receive dividends that consist of tax-exempt interest, these dividends are not taxable to you. However, 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 (AMT). If you receive exempt-interest dividends, you should get

Form 6251, *Alternative Minimum Tax—Individuals*, for more information.

Return of Capital (Nontaxable) Distributions

A distribution that is not out of earnings and profits is a return of your investment, or capital, in the mutual fund and is shown in box 1d of Form 1099–DIV. These returns of capital distributions are not taxed as ordinary dividends and are sometimes called tax-free dividends or nontaxable distributions. However, they may be fully or partly taxable as capital gains.

A return of capital distribution reduces your basis in the shares. Basis is explained later. Your basis cannot be reduced below zero. If your basis is reduced to zero, you must report the return of capital distribution on your tax return as a capital gain. The distribution is taxable if it, when added to all return of capital distributions received in past years, is more than your basis in the shares. 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 1991 for $12 a share. In 1992, you received a return of capital distribution of $5 a share. You reduced your basis in each share by the $5 received to an adjusted basis of $7. In 1993, you received a return of capital distribution of $1 per share and further reduced your basis in each share to $6. In 1994, you received a return of capital distribution of $2 per share. Your basis is now reduced to $4. In 1995, the return of capital distribution from the mutual fund is $5 a share. You will report the excess ($1 per share) as a long-term capital gain on Schedule D.

Reinvestment of Distributions

Most mutual funds permit shareholders to automatically reinvest distributions including dividends and capital gains in more shares in the fund through a dividend reinvestment plan. Instead of receiving cash, your distributions are used to purchase additional shares in the fund. You must report the reinvested amounts the same way as you would report them if you received them in cash.

How the distributions are reported depends on the kind of distribution reinvested. This means that reinvested ordinary dividends and capital gains 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 the discussion above. See *Basis of Shares Sold*, later, to determine the basis of the additional shares.

How To Report

Your mutual fund reports amounts distributed to you and amounts allocated to you on Form 1099–DIV, or on a substitute form containing substantially the same language. If the total distribution reported to you by the fund includes only ordinary dividends of $400 or less, report the entire amount on line 9, Form 1040. Otherwise, you may have to file additional schedules along with Form 1040 depending on the nature of the dividend income you receive.

Table 1, Reporting Mutual Fund Distributions on Form 1040, explains where on Form 1040 or its related schedules to report distributions from mutual funds. An explanation of the different types of distributions shown in the table was given earlier under *Tax Treatment of Distributions*.

You may be able to file Form 1040A if you had no capital gain or return of capital distributions.

Foreign tax deduction or credit. Some mutual funds invest in foreign securities or other 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 to each country or possession and the part of the dividend derived from sources in each country or possession.

You must complete Form 1116 if you choose to claim the 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, get Publication 514.

Sales, Exchanges, and Redemptions

When you sell, exchange, or redeem your mutual fund shares, you will generally have a taxable gain or a deductible loss. This includes shares in a tax-exempt mutual fund. The amount of the gain or loss is the difference between your adjusted basis in the shares and the amount you realize from the sale, exchange, or redemption. ''Adjusted basis'' and ''amount you realize'' are defined later under *Gains and Losses*.

In general, a sale is a transfer of shares for money only. An exchange is a transfer of shares in return for other shares. A redemption occurs when a fund reacquires its shares. Sales, exchanges, and redemptions are all treated as taxable sales of capital assets.

Exchange of shares in one mutual fund for shares in another mutual fund. Any exchange of one fund for another fund is a taxable exchange, even though you may be able to exchange shares in one mutual fund for shares in another mutual fund that has the same distributor or underwriter without paying a sales charge. Report any gain or loss on the investment in the original shares 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*, later, under *Basis of Shares Sold*.

Information returns. Brokers must report to the Internal Revenue Service the proceeds from sales, exchanges, or redemptions. Brokers must give each customer a written statement with that information by January 31 of the year following the calendar year the transaction occurred. Form 1099–B, *Proceeds From Broker and Barter Exchange Transactions*, or a substitute, may be used for this purpose. 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 sales reported on Form(s) 1099–B is **more** than the total you report on lines 3 and 11 of Schedule D, attach a statement to your return explaining the difference.

No information return is required if the mutual fund figures its current price per share for purposes of distributions, redemptions, and purchases so as to stabilize the price per share at a constant amount close to its issue price or the price at which it was originally sold to the public.

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 at a rate of 31% on the gross proceeds of a transaction, and you may be penalized.

Basis of Shares Sold

If you dispose of your shares in a mutual fund, it is important that you know their basis to figure your gain or loss. The basis depends on how the shares were acquired.

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 and the price you received for your 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.

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).

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 these 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).

You cannot add the fee or load charge to your cost if all of the following apply:

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

Type of Distribution	Where to Report If Total Dividends From All Payers Are:	
	$400 or Less	**More than $400**
Gross Dividends Form 1099–DIV, Box 1a	Total amount in Box 1(a) is not separately entered on form or schedule	Schedule B, line 5
Ordinary Dividends Form 1099–DIV, Box 1b	Form 1040, line 9	Already included in Gross Dividend amount on line 5 of Schedule B
Capital Gain Distributions Form 1099–DIV, Box 1c	Any other Schedule D transactions? ***No—**Form 1040, line 13 **Yes—**Schedule D, line 14	*Schedule B, line 7 (Follow instruction on Schedule B)
Nontaxable Distributions Form 1099–DIV, Box 1d	Basis of shares reduced to zero? **No—**Nontaxable until zero **Yes—**Report on Schedule D	Schedule B, line 8 (Follow instruction on Schedule B)
Exempt-Interest Dividends (Not included on Form 1099–DIV)	Form 1040, line 8b	Form 1040, line 8b
Undistributed Capital Gains Form 2439, line 1 Form 2439, line 2	 **Gain—**Schedule D, line 12 **Tax—**Form 1040, line 60	 **Gain—**Schedule D, line 12 **Tax—**Form 1040, line 60

***Caution:** It will be to your advantage to report your capital gain distributions on Schedule D if your taxable income (Form 1040, line 37) exceeds certain amounts. See explanation, later, under ''How to Figure Gains and Losses on Schedule D.''

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

If the load charge is reduced, rather than waived, the amount in excess of the reduction is added to the cost of the original shares.

The amount of the load charge that is reduced or waived is added to the cost basis of the new shares (unless all of the above items apply to the purchase of the new shares).

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

Shares Acquired by Reinvestment

If you participate in an automatic reinvestment plan, keep the statements that show each date, amount, and number of full or fractional shares purchased. You should keep track of any adjustments to the basis of your mutual fund shares when the adjustment occurs.

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

Ordinary dividends and capital gain distributions. The amount of the distribution used to purchase each full or fractional share is the cost basis for that share.

Exempt-interest dividends. The amount of the dividend used to purchase each full or fractional share is the cost basis for that share, even though exempt-interest dividends are not reported as income.

Shares Acquired by Gift

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

The donor's adjusted basis,

The date of the gift,

The fair market value at the time of the gift, and

Any gift tax paid on the gift of the shares.

Donor's adjusted basis. The donor's adjusted basis is the original cost or other original basis increased by such things as undistributed capital gains and decreased by such things as return of capital. Adjusted basis is discussed later.

Fair market value. The fair market value (FMV) of a share in a mutual fund you acquired by gift after 1954 is the public redemption price (commonly known as both the ''bid price'' or the ''net asset value'') at the time the gift was made. If you cannot determine the net asset value in effect at the time of the gift, use the last net asset value quoted by the fund for the date of the gift. If no net asset value is quoted for the date of the gift, for example, if that day falls on a Saturday, Sunday, or holiday, use the last net asset value quoted by the fund for the first day preceding the date of the gift for which there is a quoted value.

Note: For the FMV of a closed end mutual fund, see *Stocks and Bonds* in Publication 448, *Federal Estate and Gift Taxes*. Closed end mutual funds have a fixed number of shares and are traded on an open stock exchange.

Fair market value less than donor's adjusted basis. If the shares were given to you, and their FMV 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 their FMV 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 a gift of 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 more than donor's adjusted basis. If the shares were given to you, and their FMV at the time of the gift was 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.

Gifts received after 1976. If you received a gift ***after 1976***, part of the gift tax paid on the gift is added to the basis. This part is figured as follows:

$$\text{Gift tax paid} \times \frac{\text{Net increase in value of gift}}{\text{FMV of gift}} = \text{Amount added to basis for gift tax paid}$$

The net increase in value of the gift is the excess of the FMV of the gift over the donor's adjusted basis just before the gift. The basis of the gift cannot be more than the FMV of the property at the time of the gift.

Example. You were given shares in Mutual Fund B in 1989. At the time of the gift, the donor's adjusted basis in the shares was $34,400 and the FMV was $43,000. A gift tax of $2,200 was paid on the gift. The net increase in value of the gift was $8,600 ($43,000 – $34,400). The increase in the basis of the shares for the gift tax paid is $440 figured as follows:

$$\$2,200 \times \frac{\$8,600}{\$43,000} = \$440$$

Your adjusted basis in the shares is $34,840, the donor's adjusted basis ($34,400) plus part of the gift tax paid on the gift ($440).

Gifts received before 1977. For gifts made on or after September 2, 1958, but ***before 1977***, any gift tax paid on the gift is added to the basis, but the basis cannot be more than the FMV of the gift at the time of the gift.

Example 1. You were given shares in Fund A in 1968. At the time of the gift, the shares had a fair market value of $21,000 and their adjusted basis to the donor was $20,000. The donor paid a tax of $500 on the gift. Your basis for gain or loss is $20,500, the donor's adjusted basis plus the gift tax paid on the gift.

Example 2. Assume the same facts as in Example 1, except that the gift tax paid was $1,500. Your basis is $21,000, the donor's adjusted basis plus the gift tax paid on the gift, limited to the FMV of the shares at the time of the gift.

Shares Acquired by Inheritance

If you inherited shares in a mutual fund, your basis is generally their FMV at the date of the decedent's death, or at the alternate valuation date, if chosen for estate tax purposes.

Shares decedent received as a gift. The above rule does not apply to appreciated property you or your spouse receive from a decedent if all the following conditions apply.

1) You or your spouse originally gave the shares to the decedent after August 13, 1981.
2) You gave the shares to the decedent during the one-year period ending on the date of death.
3) The death occurred after 1981.

In this situation, the basis of the shares is the decedent's adjusted basis in the shares immediately before his or her death, rather than their FMV. ***Appreciated property*** is any property (including mutual fund shares) whose FMV on the day it was given to the decedent is more than its adjusted basis.

If the estate, or a trust of which the decedent was the grantor, sells the appreciated property and the donor (or the donor's spouse) is entitled to the proceeds, the estate's or trust's basis in the property is the decedent's adjusted basis immediately before death.

Determining fair market value of inherited shares. The FMV of a share in a mutual fund acquired from a person who died after August 16, 1954, is the last quoted public redemption price (commonly known as the "bid price" or "net asset value") on the date of death, or the alternate valuation date, if chosen for estate tax purposes. If no net asset value is quoted for the date of death or the alternate valuation date (for example, if that day falls on a Saturday, Sunday, or holiday), use the last net asset value quoted by the fund for the first day preceding the date of death (or the alternate valuation date) for which there is a quoted value. If a dividend was declared before the date of death and was payable after that date, the dividend is added to the ex-dividend quotation (price quoted excluding the value of a pending dividend) to determine the share's FMV.

Note: For the FMV of a closed end mutual fund, see *Stocks and Bonds* in Publication 448. Closed end mutual funds have a fixed number of shares and are traded on an open stock exchange.

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 fair market value 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 and the basis of the other half to the decedent's heirs 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. (Community property state laws override joint tenancy rules.) This is true, regardless of the form in which title was taken.

Adjusted Basis

The adjusted basis of stock is the original basis, increased or reduced as described here.

Additions to basis. Your basis in the fund is increased by 65% of the undistributed capital gain (the difference between your share of the undistributed capital gain on Form 2439, line 1, and the tax considered paid by you on Form 2439, line 2).

This puts you in the same position as if you had actually received the capital gain, paid the tax on it, and then reinvested the difference in the same mutual fund. You should receive Form 2439 from your mutual fund which will show the amounts to include. You should keep Copy C of Form 2439 as part of your records to show increases in the basis of your shares.

Reduction of basis. You must reduce the original basis by the amount you receive from the fund that represents a return of capital. Do not reduce your basis for distributions from the fund that are exempt-interest dividends.

Worksheet. *Table 2, Mutual Fund Record*, is a worksheet that can be used to keep track of the adjusted basis of your mutual fund shares. Enter the cost per share when purchased and any adjustments to the basis when the adjustment occurs. Figure the adjusted basis when the shares are sold or redeemed.

Identifying the Shares Sold

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, the process can be more difficult. You may choose to use either the **cost basis** or the **average basis**.

Cost Basis

Under the *cost basis*, you can choose one of the following methods:

- Specific share identification, or
- First-in first-out (FIFO)

Specific share identification. If you can definitely 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

Table 2. **Mutual Fund Record**

Mutual Fund	Acquired[1]			Adjustments 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 shares received from reinvestment of dividends.
[2]Cost plus or minus adjustments.

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 of your specification from your broker **in writing** within a reasonable time.

The confirmation by the mutual fund **must** confirm that you instructed your broker to sell particular shares. You continue to have the burden of proving that you owned the specified shares at the time of sale or transfer.

First-in first-out (FIFO). If the 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. Therefore, the oldest shares still available 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* shows how to figure basis on a sale of shares in a mutual fund using the FIFO method. It also shows how to figure basis using the average basis method, discussed next

Average Basis

You may choose to use an average basis to figure your gain or loss when you sell all or part of your shares in a regulated investment company, 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.

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

Example. You own two accounts in 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.

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

- Single-category method
- Double-category method

Single-category method. In the single-category method, you find the average cost of **all** shares owned at the time of disposition, regardless of how long you owned them. Include shares acquired with reinvested dividends or capital gains distributions.

To compute the basis of your shares sold, follow these steps:

1) ADD: Cost of all shares owned.
2) DIVIDE: Cost of all shares by number of shares owned. This is your **average basis per share**.
3) MULTIPLY: Result of #2 (average cost per share) by number of shares sold.

Example 1. You bought the following shares in the LJP Mutual Fund: 100 shares in 1992 at $10 per share; 100 shares in 1993 at $12 per share; and 100 shares in 1994 at $26 per share. On May 16, 1995, you sold 150 shares. The basis of shares sold is $2,400, computed as follows:

Total cost ($1,000 + $1,200 + $2,600)	$4,800
Average basis per share ($4,800 ÷ 300)	16.00
Basis of shares sold (16.00 × 150)	$2,400

Remaining shares. The basis of your shares determined under average basis is the

Table 3. **How to Figure Basis of Shares Sold**

This is an example showing two different ways to figure basis. It compares the FIFO method and the average basis (single-category) method.

Date	Action	Share Price	No. of Shares	Shares Owned
2/4/94	Invest $4,000	$25	160	160
8/5/94	Invest $4,800	$20	240	400
12/16/94	Reinvest $300 dividend	$30	10	410
9/29/95	Sell $6,720	$32	210	200

FIFO	1. *FIFO*: To figure the basis of the 210 shares sold on 9/29/95, use the share price of the first 210 shares you bought, namely the 160 shares you purchased on 2/4/94 and 50 of those purchased on 8/5/94. $4,000 (cost of 160 shares on 2/4/94) + $1,000 (cost of 50 shares on 8/5/94) **Basis**= $5,000
AVERAGE BASIS	2. *AVERAGEBASIS* (single-category): To figure the basis of the 210 shares sold on 9/29/95, use the average basis of all 410 shares owned on 9/29/95. $9,100 (cost of 410 shares) ÷ 410 (number of shares) $22.20 (average basis per share) $22.20 × 210 **Basis**= $4,662

basis of ***all*** your shares in the account. That is, the basis of the remaining shares is the same as the basis of the shares sold.

Example 2. Using the same facts as in Example 1, assume you sold an additional 50 shares on December 15, 1995 at $20 per share. You would not recompute the average basis of the 150 shares you owned at that time; rather, your basis is the $16 per share computed earlier.

Even though you use only one category to compute basis, you may have short-term or long-term gains or losses. To determine your holding period, the shares disposed of are considered to be those acquired first. See *Holding Period*, later.

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 one year or less are short-term. Shares held longer than one year are long-term.

The adjusted basis of each share in a category is the total adjusted basis of all shares in that category at the time of disposition divided by the total shares in the category. You may 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, any remaining shares sold against the short-term category.

Changing categories. After you have held a mutual fund share for more than one year, you must transfer that share from the short-term category to the long-term category. When you make the change, the basis of a transferred share is its actual cost or adjusted basis to you, or if some of the shares in the short-term category have been disposed of, its basis under the average basis method. The basis of the undisposed shares left in the short-term category that are changed to the long-term category is the average basis of the shares in the short-term category 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.

Making the choice for gift shares. 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 less than the donor's basis, special rules apply. To use the average basis, you must submit a statement with your initial choice to use one of the average basis methods. It must state that the basis used in figuring the average basis of the gift shares under either method will be the FMV at the time of the gift. This statement applies to gift shares you receive before and after making the choice, as long as the choice to use the average basis is in effect. If you do not make this statement, you cannot choose to use the average basis for any account that contains gift shares.

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.

Adjusted basis. Adjusted basis is your original cost or other basis adjusted for such things as return of capital distributions.

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 (such as redemption fees, sales commissions, sales charges, or exit fees).

Reporting on Schedule D (Form 1040). Brokers report dispositions of mutual fund shares on Form 1099–B, or a substitute form containing substantially the same language. The form shows the sales price and indicates whether the amount reported is the gross amount or the net amount (gross minus sales expenses).

Caution: As this publication was being prepared for print, Congress was considering legislation that would affect capital gains and losses. The line numbers on Schedule D (Form 1040) could change for 1995. See Publication 553, *Highlights of 1995 Tax Changes*, for further developments.

If your Form 1099–B or similar statement from the broker shows the gross sales price, do not subtract the sales commissions from it when reporting your sales price in column (d) on Schedule D. Instead, report the gross amount in column (d) and increase your cost or other basis, column (e), by any expense of the sale such as sales commissions. 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 and ***do not*** increase your basis in column (e) by the sales commission.

Example 1. You sold 100 shares of Fund B 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 IRS. Report this amount in column (d) of Schedule D.

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

Holding Period

When you dispose of your mutual fund shares, you must determine your holding period. Determine your holding period by using the trade dates. The **trade date** is the date on which you contract to buy or sell the mutual fund shares. 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. Most mutual funds will show the trade date on your purchase and sale confirmation statements.

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

To find out how long you have held your shares, begin counting on the day after the day you bought the shares. (The day you bought the shares is the trade date.) This same date of each succeeding month is the start of a new month regardless of the number of days in the month before. The day you dispose of the shares (trade date) is also part of your holding period.

Example. If you bought the shares on January 10, 1995 (trade date), you start counting on January 11, and the 11th of each following month is the beginning of a new month. Therefore, if you sold the shares on January 10, 1996 (trade date), your holding period would not be more than one year. If you sold them on January 11, 1996, your holding period would be more than one 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 one year (even if you disposed of the shares within one year after the decedent's death) if your basis is:

1) The FMV at the date of the decedent's death (or the alternate valuation date), or
2) The decedent's adjusted basis in the case of shares described earlier in *Shares decedent received as a gift*, under *Shares Acquired by Inheritance*.

Report the sale of inherited mutual fund shares on line 9 of Schedule D and write ''Inherited'' in column (b) instead of the date you acquired the shares.

Reinvested dividends. If you participate in an automatic dividend reinvestment plan, each full share or fractional share is considered to have been purchased on the date that each share was purchased for you. Therefore, if you sell all or part of your mutual fund shares, you might have some short-term and some long-term gains and losses.

Certain short-term losses. Special rules 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. If you received exempt-interest dividends on mutual fund shares that you held for 6 months or less and sold those shares at a loss, you may claim only the part of the loss that is more than the exempt-interest dividends. Increase the sales price reported on line 1, column (d) of Schedule D by the loss not allowed. Report the loss as a short-term capital loss.

Example. On January 6, 1995, you bought a mutual fund share for $40. On February 1, 1995, the mutual fund paid a $5 dividend from tax-exempt interest, which is not taxable to you. On February 8, 1995, you sold the share for $34. If it were not for the tax-exempt dividend, your loss would be $6 ($40 − $34). However, you can deduct only $1, the part of the loss that is more than the exempt-interest dividend ($6 − $5). On Schedule D, column (d), increase the sales price from $34 to $39 (the $5 portion of the loss that is not deductible). You may deduct only $1 as a short-term capital loss.

Capital gain distribution before short-term loss. If you received, or were considered to have received, capital gain distributions 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 as a short-term capital loss. The part of the loss that is not more than the capital gain distribution is reported as a long-term capital loss. There is an exception for losses on distributions of shares under a periodic liquidation plan.

Example. On April 12, 1995, you bought a mutual fund share for $20. On June 30, 1995, the mutual fund paid a capital gain distribution of $2 a share, which is taxed as a long-term capital gain. On July 11, 1995, 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. 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.

How To Figure Gains and Losses on Schedule D

Caution: As this publication was being prepared for print, Congress was considering legislation that would affect capital gains and losses. The line numbers on Schedule D (Form 1040) could change for 1995. See Publication 553, *Highlights of 1995 Tax Changes*, for further developments.

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 separately in columns (f) and (g) of Part I, Schedule D (Form 1040), *Capital Gains and Losses*. Enter the totals on line 7, for both columns, and subtract the smaller total from the larger one. This is the net short-term capital gain or loss. Enter this amount on line 8 of Part I.

Net long-term capital gain or loss. Net long-term capital gain or loss is determined by adding the gains and losses separately in columns (f) and (g) of Part II, Schedule D (Form 1040). Enter the totals on line 16 for both columns, and subtract the smaller total from the larger one. This is the net long-term capital gain or loss. Enter this amount on line 17 of Part II.

In figuring the long-term capital gain, you should include on line 14 of Part II, Schedule D (Form 1040), capital gain distributions received from mutual funds during the year, unless you are not required to report any other capital gains or losses. If you do not need Schedule D for other capital transactions, enter your capital gain distributions on line 13 of Form 1040.

Total Net Capital Gain or Loss

The total net capital gain or loss is determined by combining the net short-term capital gain or loss on line 8 with the net long-term capital gain or loss on line 17. Enter the result on line 18 of Part III, Schedule D (Form 1040).

Net capital gain. If line 18 of Part III, Schedule D (Form 1040) shows a gain, enter the amount on line 13 of Form 1040.

Note. The highest tax rate on taxable income for individuals is 39.6%. However, the maximum tax rate on net capital gain income is 28%. If you have a long-term capital gain on line 17, and a net gain on line 18 of Schedule D, you may need to complete the *Capital Gain Tax Worksheet* in the Form 1040 instructions to figure your tax.

Complete this worksheet only if your taxable income (line 37, Form 1040) is more than the amount shown below for your filing status.

Filing Status	Amount
Single	$ 56,550
Married filing jointly	94,250
Qualifying widow(er) with dependent child	94,250
Married filing separately	47,125
Head of household	80,750

Net capital loss. If you have a net capital 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 net capital loss, as shown on line 18 of Schedule D.

Enter your allowable loss on line 13 of Form 1040.

Example 1. Bob and Gloria sold all of their shares in a mutual fund in 1995. The sale resulted in a capital loss of $7,000. They had no other sales of capital assets in 1995. On their joint return, they can deduct $3,000, which is the smaller of their loss or the net capital loss limit.

If Bob and Gloria's capital loss had been $2,000, their capital loss deduction would have been $2,000, because it is less than the $3,000 limit.

Example 2. Margaret has capital gains and losses for the year as follows:

	Short-term	Long-term
Gains	$ 700	$ 400
Losses	(800)	(2,000)

Margaret's deductible capital loss is $1,700, which she figures as follows:

Short-term capital losses	($ 800)	
Subtract short-term capital gains	700	
Net short-term capital loss		($ 100)
Long-term capital losses	($2,000)	
Subtract long-term capital gains	400	
Net long-term capital loss		($1,600)
Deductible capital loss		($1,700)

Example 3. In 1995, Mary and Les file a joint return. They have a net long-term capital loss of $5,600 and a net short-term capital gain of $450. Their net capital loss is $5,150 ($5,600– $450). Because their net capital loss exceeds $3,000, the amount they may deduct in 1995 is limited to $3,000.

Capital loss carryovers. If your net capital losses are more than your allowable net capital loss deduction, you may carry over the excess to later years until it is completely used up. To determine your capital loss carryover, subtract from your capital 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 with a negative number.

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.

In determining your capital loss carryover, apply your capital loss deduction to reduce your net short-term losses first. If after applying the short-term losses, the capital loss limit has not been reached, then apply the long-term losses until you reach the limit.

Use the *Capital Loss Carryover Worksheet* in the Schedule D instructions to figure your capital loss carryover.

Capital loss carryovers from separate returns are combined if you file a joint return for the current year. 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.

For more information on figuring capital loss carryovers, get Publication 550.

Investment Expenses

You can generally deduct the expenses of producing 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. See *Limit on Investment Interest Expense*, later.

Publicly offered mutual funds. Generally, mutual funds are publicly offered funds. 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 only deduct your share of the investment expenses on your Schedule A (Form 1040) as a miscellaneous itemized deduction to the extent your miscellaneous deductions exceed 2% of your adjusted gross income. Your share of the expenses will be shown in box 1e 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 not held by at least 500 persons at all times 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 partly for both taxable and tax-exempt income. One accepted method for allocating expenses is to divide them in the same proportion that your tax-exempt income from the mutual fund is to your total income from the fund. To do this, you must first divide your tax-exempt income by your total income. Then multiply the result by your expenses to find the part of the expenses that relates to the tax-exempt income. 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 ($480 ÷ $600 = .80). Therefore, 80% 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 deduction subject to the 2% of adjusted gross income limit. That part of the expense is 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 using the method of allocation just explained under *Expenses allocable to exempt-interest dividends.*

Second, investment interest is limited by the amount of investment income. This is explained in the following discussions.

Limit on deduction. Your deduction for investment interest expense is limited to the amount of your ***net investment income*** only. There is no current deduction for excess investment interest expense. However, see *Carryover*, later.

Net investment income, for these purposes, is figured by subtracting from your investment income:

1) Investment expenses other than interest, and
2) Any allowed passive activity losses other than rental real estate activity.

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 or capital gain distributions from mutual fund shares. However, you can choose to include part or all of your net capital gain in investment income. For information on this choice, see Chapter 3 of Publication 550.

Investment expenses include all income-producing expenses relating to the investment property, other than interest expense, that are allowable deductions after subtracting 2% of adjusted gross income. In computing the amount of expenses that exceeds the 2% limit, miscellaneous expenses that are not investment expenses are disallowed before any investment expenses are disallowed.

For information on the 2% limit, get Publication 529, *Miscellaneous Deductions*. For more information on passive activity losses, get Publication 925, *Passive Activity and At-Risk Rules*.

Example. Jane, a single taxpayer, has investment income in 1995 of $12,000. Jane's 1995 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 in 1995. She had no passive activity losses. Jane figures net investment income and the limits on her investment interest expense deduction for 1995 as follows:

Total investment income	$12,000
Subtract: Investment expenses (other than interest)	980
Net investment income	$11,020
Subtract: Investment interest expense	12,500
Excess interest expense not allowed in 1995	$ 1,480

For 1995, Jane's investment interest expense deduction is limited to $11,020 (her net investment income). The disallowed interest expense of $1,480 can be carried forward to 1996 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, *Investment Interest Expense Deduction*, to figure your investment interest expense deduction. For more information about investment interest expense, get Publication 550.

Comprehensive Example

James and Mary Jones, a married couple, file a joint return for calendar year 1995, and decide not to itemize their deductions. During the year, James received gross wages of $49,250 and had $5,120 Federal income tax withheld. He also paid $1,300 in estimated tax.

James and Mary received $2,425 in interest income from their joint savings account.

They are joint shareholders in Green Publishing Company and received $250 in ordinary dividends.

James and Mary were joint owners of 200 shares of Mutual Fund X, which they sold on January 6, 1995. These shares were purchased in 1980. They had not requested that Mutual Fund X reinvest their distributions. Mutual Fund X sent them Form 1099–B, shown later.

They also are joint shareholders in Mutual Fund A. They purchased 50 shares for $1,000 on January 6, 1995. James and Mary have requested that the fund reinvest all of their distributions which amounted to $200 in 1995. After the close of the year the fund sent them Form 1099–DIV, shown later.

Form 1040. James and Mary fill in the requested information at the top of Form 1040, including Filing Status and Exemptions. (See illustration.) On line 7, they enter James' salary of $49,250. Since they have more than $400 each of interest and dividend income, they must fill out all of Schedule B (Form 1040). They must also complete Schedule D to report their capital gains.

Schedule B (Form 1040). On line 1, Part I, they enter their bank's name and the interest received of $2,425. They also complete lines 2 and 4 of Schedule B and enter the $2,425 on line 8a of Form 1040. On line 5, Part II of Schedule B (Form 1040), James and Mary list their $250 ordinary dividends from Green Publishing Company and their $200 gross distributions from Mutual Fund A (from box 1a, Form 1099–DIV). They enter the total of $450 on line 6, Schedule B.

On line 7, they enter the $25 listed in box 1c of Form 1099–DIV as *Capital gain distributions*. On line 8, they enter $6.00 ($5.60 rounded) from box 1d of Form 1099–DIV as *Nontaxable distributions*. They add lines 7 and 8 and enter the total on line 9. They subtract line 9 from line 6 and enter the result on line 10. This amount is their ordinary (taxable) dividends. They enter it on line 9, Form 1040.

Schedule D (Form 1040). James and Mary report the sale of their shares in Mutual Fund X in Part II of Schedule D. They purchased 200 shares on July 10, 1980, for $10 a share. In 1981, 1984, and 1990, they received return of capital distributions that reduced the basis in the shares. See their *Mutual Fund Record*, shown later. Their adjusted basis is $9.89 a share for a total of $1,978. They enter this amount on line 9, column (e). They sold the shares on January 6, 1995, for $14.89 a share, a total of $2,978. They enter this amount on line 9, column (d). Their long-term capital gain is $1,000, which they show in column (g).

On line 14, Part II, they enter their capital gain distribution of $25 (line 7, Schedule B).

James and Mary add lines 9 and 14, column (g), and enter the net long-term capital gain of $1,025 on lines 16 and 17. Since they have no short-term capital transactions, they enter the net gain of $1,025 on line 18, Part III, and on line 13, Form 1040.

Completing Form 1040. James and Mary add lines 7 through 21 and enter the total on line 22. Next, they figure their adjusted gross income, taxable income, and tax liability.

Basis. During the calendar year, the return of capital distribution from Mutual Fund A changed the basis in the shares that James and Mary held at that time. Therefore, they figure their current adjusted basis in their personal records. This figure will be needed when they sell or exchange their shares.

The cost basis in Mutual Fund A shares purchased by James and Mary at the beginning of the year was $20 a share. They requested that all distributions to which they were entitled be reinvested in the fund. Therefore, the fund used their total distributions of $200 ($50 a quarter) to buy 8 additional shares at $25 a share.

A return of capital of $5.60 (listed in box 1d of Form 1099–DIV as *Nontaxable distributions*) received in November reduces their basis in the shares they owned at that time.

James and Mary keep track of their investment in Mutual Fund A using the *Mutual Fund Record*, illustrated later.

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return (1) **1995** IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1995, or other tax year beginning , 1995, ending , 19 OMB No. 1545-0074

Label

(See instructions on page 11.)
Use the IRS label. Otherwise, please print or type.

LABEL HERE

Your first name and initial: JAMES A	Last name: JONES	Your social security number: 123 00 4567
If a joint return, spouse's first name and initial: MARY B	Last name: JONES	Spouse's social security number: 234 00 5678
Home address (number and street). If you have a P.O. box, see page 11.: 3702 MAPLE ROAD	Apt. no.	**For Privacy Act and Paperwork Reduction Act Notice, see page 7.**
City, town or post office, state, and ZIP code. If you have a foreign address, see page 11.: HOMETOWN, VA 22000		

Presidential Election Campaign (See page 11.)

	Yes	No
Do you want $3 to go to this fund?	X	
If a joint return, does your spouse want $3 to go to this fund?	X	

Note: Checking "Yes" will not change your tax or reduce your refund.

Filing Status

(See page 11.)
Check only one box.

1 ☐ Single
2 ☒ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See page 12.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 12.)

Exemptions

(See page 12.)

6a ☒ **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a. But be sure to check the box on line 33b on page 2
b ☒ **Spouse**

No. of boxes checked on 6a and 6b: 2

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number. If born in 1995, see page 13.	(3) Dependent's relationship to you	(4) No. of months lived in your home in 1995

If more than six dependents, see page 13.

No. of your children on 6c who:
- lived with you
- didn't live with you due to divorce or separation (see page 14)

Dependents on 6c not entered above

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶ ☐
e Total number of exemptions claimed

Add numbers entered on lines above ▶ 2

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.

If you did not get a W-2, see page 14.

Enclose, but do not attach, your payment and payment voucher. See page 33.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	49,250
8a	**Taxable** interest income (see page 15). Attach Schedule B if over $400	8a	2,425
b	**Tax-exempt** interest (see page 15). DON'T include on line 8a (8b)		
9	Dividend income. Attach Schedule B if over $400	9	419
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 15)	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). If required, attach Schedule D (see page 16)	13	1,025
14	Other gains or (losses). Attach Form 4797	14	
15a	Total IRA distributions (15a) — b Taxable amount (see page 16)	15b	
16a	Total pensions and annuities (16a) — b Taxable amount (see page 16)	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation (see page 17)	19	
20a	Social security benefits (20a) — b Taxable amount (see page 18)	20b	
21	Other income. List type and amount—see page 18	21	
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22	53,119

Adjustments to Income

23a	Your IRA deduction (see page 19)	23a	
b	Spouse's IRA deduction (see page 19)	23b	
24	Moving expenses. Attach Form 3903 or 3903-F	24	
25	One-half of self-employment tax	25	
26	Self-employed health insurance deduction (see page 21)	26	
27	Keogh & self-employed SEP plans. If SEP, check ▶ ☐	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid. Recipient's SSN ▶	29	
30	Add lines 23a through 29. These are your **total adjustments** ▶	30	

Adjusted Gross Income

31	Subtract line 30 from line 22. This is your **adjusted gross income**. If less than $26,673 and a child lived with you (less than $9,230 if a child didn't live with you), see "Earned Income Credit" on page 27 ▶	31	53,119

Cat. No. 11320B Form **1040** (1995)

Tax Computation

(See page 23.)

32	Amount from line 31 (adjusted gross income)	53,119
33a	Check if: ☐ You were 65 or older, ☐ Blind; ☐ Spouse was 65 or older, ☐ Blind. Add the number of boxes checked above and enter the total here ▶ 33a	
b	If your parent (or someone else) can claim you as a dependent, check here ▶ 33b ☐	
c	If you are married filing separately and your spouse itemizes deductions or you are a dual-status alien, see page 23 and check here ▶ 33c ☐	
34	Enter the larger of your: Itemized deductions from Schedule A, line 28, OR Standard deduction shown below for your filing status. But if you checked any box on line 33a or b, go to page 23 to find your standard deduction. If you checked box 33c, your standard deduction is zero. • Single—$3,900 • Married filing jointly or Qualifying widow(er)—$6,550 • Head of household—$5,750 • Married filing separately—$3,275	6,550
35	Subtract line 34 from line 32	46,569
36	If line 32 is $86,025 or less, multiply $2,500 by the total number of exemptions claimed on line 6e. If line 32 is over $86,025, see the worksheet on page 23 for the amount to enter	5,000
37	Taxable income. Subtract line 36 from line 35. If line 36 is more than line 35, enter -0-	41,569
38	Tax. Check if from a ☒ Tax Table, b ☐ Tax Rate Schedules, c ☐ Capital Gain Tax Worksheet, or d ☐ Form 8615 (see page 24). Amount from Form(s) 8814 ▶ e	6,571
39	Additional taxes. Check if from a ☐ Form 4970 b ☐ Form 4972	
40	Add lines 38 and 39 ▶	6,571

If you want the IRS to figure your tax, see page 35.

Credits

(See page 24.)

41	Credit for child and dependent care expenses. Attach Form 2441		
42	Credit for the elderly or the disabled. Attach Schedule R		
43	Foreign tax credit. Attach Form 1116		
44	Other credits (see page 25). Check if from a ☐ Form 3800 b ☐ Form 8396 c ☐ Form 8801 d ☐ Form (specify)		
45	Add lines 41 through 44		
46	Subtract line 45 from line 40. If line 45 is more than line 40, enter -0- ▶		6,571

Other Taxes

(See page 25.)

47	Self-employment tax. Attach Schedule SE	
48	Alternative minimum tax. Attach Form 6251	
49	Recapture taxes. Check if from a ☐ Form 4255 b ☐ Form 8611 c ☐ Form 8828	
50	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	
51	Tax on qualified retirement plans, including IRAs. If required, attach Form 5329	
52	Advance earned income credit payments from Form W-2	
53	Household employment taxes. Attach Schedule H	
54	Add lines 46 through 53. This is your total tax ▶	6,571

Payments

Attach Forms W-2, W-2G, and 1099-R on the front.

55	Federal income tax withheld. If any is from Form(s) 1099, check ▶ ☐	5,120	
56	1995 estimated tax payments and amount applied from 1994 return	1,300	
57	Earned income credit. Attach Schedule EIC if you have a qualifying child. Nontaxable earned income: amount ▶ and type ▶		
58	Amount paid with Form 4868 (extension request)		
59	Excess social security and RRTA tax withheld (see page 32)		
60	Other payments. Check if from a ☐ Form 2439 b ☐ Form 4136		
61	Add lines 55 through 60. These are your total payments ▶		6,420

Refund or Amount You Owe

62	If line 61 is more than line 54, subtract line 54 from line 61. This is the amount you OVERPAID		
63	Amount of line 62 you want REFUNDED TO YOU ▶		
64	Amount of line 62 you want APPLIED TO YOUR 1996 ESTIMATED TAX ▶		
65	If line 54 is more than line 61, subtract line 61 from line 54. This is the AMOUNT YOU OWE. For details on how to pay and use Form 1040-V, Payment Voucher, see page 33 ▶		151
66	Estimated tax penalty (see page 33). Also include on line 65		

Sign Here

Keep a copy of this return for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation
James A. Jones	4-5-96	MANAGER
Spouse's signature. If a joint return, BOTH must sign.	**Date**	**Spouse's occupation**
Mary B. Jones	4-5-96	Housewife

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed ☐	Preparer's social security no.
Firm's name (or yours if self-employed) and address		EIN	
		ZIP code	

Printed on recycled paper

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side.
JAMES A JONES and MARY B JONES

Your social security number: 123 : 00 : 4567

Schedule B—Interest and Dividend Income

Attachment Sequence No. 08

Part I Interest Income

(See pages 15 and B-1.)

Note: If you had over $400 in taxable interest income, you must also complete Part III.

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

		Amount
1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶	1	
FIRST NATIONAL BANK OF HOMETOWN		2,425
2 Add the amounts on line 1	2	2,425
3 Excludable interest on series EE U.S. savings bonds issued after 1989 from Form 8815, line 14. You MUST attach Form 8815 to Form 1040	3	
4 Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶	4	2,425

Part II Dividend Income

(See pages 15 and B-1.)

Note: If you had over $400 in gross dividends and/or other distributions on stock, you must also complete Part III.

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total dividends shown on that form.

			Amount
5 List name of payer. Include gross dividends and/or other distributions on stock here. Any capital gain distributions and nontaxable distributions will be deducted on lines 7 and 8 ▶		5	
GREEN PUBLISHING COMPANY			250
MUTUAL FUND A			200
6 Add the amounts on line 5		6	450
7 Capital gain distributions. Enter here and on Schedule D*	7 25		
8 Nontaxable distributions. (See the inst. for Form 1040, line 9.)	8 6		
9 Add lines 7 and 8		9	31
10 Subtract line 9 from line 6. Enter the result here and on Form 1040, line 9 ▶		10	419

**If you do not need Schedule D to report any other gains or losses, see the instructions for Form 1040, line 13, on page 16.*

Part III Foreign Accounts and Trusts

(See page B-2.)

If you had over $400 of interest or dividends or had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must complete this part.	Yes	No
11a At any time during 1995, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1		X
b If "Yes," enter the name of the foreign country ▶		
12 Were you the grantor of, or transferor to, a foreign trust that existed during 1995, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 926		X

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (T)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ Use lines 20 and 22 for more space to list transactions for lines 1 and 9.

OMB No. 1545-0074

1995

Attachment Sequence No. 12

Name(s) shown on Form 1040: JAMES A JONES and MARY B JONES

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-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
1						
2 Enter your short-term totals, if any, from line 21		2				
3 Total short-term sales price amounts. Add column (d) of lines 1 and 2 . . .		3				

4 Short-term gain from Forms 2119 and 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 9 of your 1994 Capital Loss Carryover Worksheet . . .	6		
7 Add lines 1 through 6 in columns (f) and (g)	7	( )	
8 Net short-term capital gain or (loss). Combine columns (f) and (g) of line 7 . . . . ▶	8		

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

(a) Description of property	(b) Date acquired	(c) Date sold	(d) Sales price	(e) Cost or other basis	(f) LOSS	(g) GAIN
9 200 Shares MUTUAL FUND X	7-10-[illegible]	[illegible]5	[illegible]	1,978		1,000
10 Enter your long-term totals, if any, from line 23		10				
11 Total long-term sales price amounts. Add column (d) of lines 9 and 10 . . .		11	2,978			

12 Gain from Form 4797; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or loss from Forms 4684, 6781, and 8824	12		
13 Net long-term gain or loss from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	13		
14 Capital gain distributions	14		25
15 Long-term capital loss carryover. Enter the amount, if any, from line 14 of your 1994 Capital Loss Carryover Worksheet	15		
16 Add lines 9 through 15 in columns (f) and (g)	16	( )	1,025
17 Net long-term capital gain or (loss). Combine columns (f) and (g) of line 16 . . . . . . ▶	17		1,025

Part III Summary of Parts I and II

18 Combine lines 8 and 17. If a loss, go to line 19. If a gain, enter the gain on Form 1040, line 13. **Note:** *If both lines 17 and 18 are gains, see the **Capital Gain Tax Worksheet** on page 24* . .	18	1,025
19 If line 18 is a loss, enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses: a The loss on line 18; **or** b ($3,000) or, if married filing separately, ($1,500)	19	( )
Note: *See the **Capital Loss Carryover Worksheet** on page D-3 if the loss on line 18 exceeds the loss on line 19 **or** if Form 1040, line 35, is a loss.*		

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11338H **Schedule D (Form 1040) 1995**

Table 2. **Mutual Fund Record**

Mutual Fund	Acquired[1]			Adjustments 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 X	*7-10-80*	*200*	*10.00*	*12-31-81* *(.05)*	*12-31-84* *(.02)*	*12-31-90* *(.04)*			*9.89*	*1-6-95*	*200*
MUTUAL FUND A	*1-6-95*	*50*	*20.00*	*12-29-95* *(.10)*							
	3-25-95	*2*	*25.00*	*12-29-95* *(.10)*							
	6-24-95	*2*	*25.00*	*12-29-95* *(.10)*							
	9-23-95	*2*	*25.00*	*12-29-95* *(.10)*							
	12-30-95	*2*	*25.00*								

[1] Include shares received from reinvestment of dividends.
[2] Cost plus or minus adjustments.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code Mutual Fund X 1015 Main Street New York, NY 02112	1a Date of sale 010695 1b CUSIP No.	OMB No. 1545-0715 1995 Form 1099-B	**Proceeds From Broker and Barter Exchange Transactions**
	2 Stocks, bonds, etc. $2,978	Reported to IRS ☐ Gross proceeds ☒ Gross proceeds less commissions and option premiums	
PAYER'S Federal identification number: 10-3456789 / RECIPIENT'S identification number: 123-00-4567	3 Bartering $	4 Federal income tax withheld $	**Copy B For Recipient**
RECIPIENT'S name James A. Jones Mary B. Jones	5 Description Mutual Fund X		This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Street address (including apt. no.) 3702 Maple Road City, state, and ZIP code Hometown, VA 22000	**Regulated Futures Contracts** 6 Profit or (loss) realized in 1995 $	7 Unrealized profit or (loss) on open contracts—12/31/94 $	
Account number (optional)	8 Unrealized profit or (loss) on open contracts—12/31/95 $	9 Aggregate profit or (loss) $	

Form **1099-B** (Keep for your records.) Department of the Treasury - Internal Revenue Service

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code Mutual Fund X 1015 Main Street New York, NY 02112	1a Date of sale 010695 1b CUSIP No.	OMB No. 1545-0715 1995 Form 1099-B	**Proceeds From Broker and Barter Exchange Transactions**
	2 Stocks, bonds, etc. $2,978	Reported to IRS ☐ Gross proceeds ☒ Gross proceeds less commissions and option premiums	
PAYER'S Federal identification number: 10-3456789 / RECIPIENT'S identification number: 123-00-4567	3 Bartering $	4 Federal income tax withheld $	**Copy B For Recipient**
RECIPIENT'S name James A. Jones Mary B. Jones	5 Description Mutual Fund X		This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Street address (including apt. no.) 3702 Maple Road City, state, and ZIP code Hometown, VA 22000	**Regulated Futures Contracts** 6 Profit or (loss) realized in 1995 $	7 Unrealized profit or (loss) on open contracts—12/31/94 $	
Account number (optional)	8 Unrealized profit or (loss) on open contracts—12/31/95 $	9 Aggregate profit or (loss) $	

Form **1099-B** (Keep for your records.) Department of the Treasury - Internal Revenue Service