Debt Instrument Election and Accrual Method Update Instructions

Debt Instrument Election and Accrual Method

Taxpayer rules surrounding elections are complex. Pershing strongly encourages clients to consult with their tax advisor before choosing to apply an alternative to the default.

Election 1 – Bond Premium Amortization (Internal Revenue Code [IRC] section 171)

In the past, Pershing had assumed the client made this election and amortized the bond premium by adjusting cost basis downward towards the par value of the bond. However, Pershing did not adjust the interest payment for this amortization. Under the new rules, Pershing will supply the IRS with the amount of amortized bond premium on purchases after January 1, 2014 unless the client elects not to amortize the bond premium.

Default rule: The IRS requires Pershing to assume that you HAVE made this election and will amortize the bond premiums on taxable debt instruments

Alternative Election: Pershing will not amortize the bond premium on taxable debt instruments.

Election 2 – Market Discount Accrual Method (IRC section 1276[b][2])

There are two different methods you can use to calculate accruals on market discount:

Ratable (Straight line): This method simply calculates accruals by dividing the discount by the number of years until the bond matures. As an example, a bond purchased at $95.00 with a remaining maturity of five years would simply accrue $1.00 of market discount per year.

Constant Yield is a more complex calculation which takes into consideration the value of money over time. For the same bond purchased at $95.00 accruals would vary, weighted slightly heavier at the end of the life of the bond. Based on the yield, it may accrue $.95 in year 1 and $1.05 in the final year.

In the past, Pershing has assumed the client has made the constant yield election. For bonds purchased in 2015, the default will be the constant yield method.

Default rule: The IRS requires Pershing to assume that the client has made the election and will calculate accruals using a constant yield method as provided in IRC section 1276(b)(2).

Alternative Election: Pershing will compute accruals of market discount using a ratable method rather than a constant yield method as provided in IRC section 1276(b)(1).

Election 3 – Include Market Discount as Income (IRC section 1278[b])

The client has a choice of paying the accrued income annually or at the final disposal of the bond. In the past, Pershing adjusted the cost of the bond upwards towards par, assuming the accrued income was being paid annually. Beginning with new purchases in 2014, Pershing is no longer permitted to assume this election has been made and will no longer adjust the cost basis on discounted bonds covered under this election.

If this election is made, cost basis will show as adjusted and the accrued income will be reported to the IRS on an annual basis.

Default rule: The IRS requires Pershing to assume that the election has not been made to include market discount as income as it accrues and will not report the yearly accruals to the IRS as additional ordinary income.

Alternative Election: Pershing will be required to report accruals of market discount as additional ordinary income to the IRS on Forms 1099 each year the election is in effect.

Debt Instrument Election and Accrual Method Update

This form is designed to notify a broker of the elections or revocations you have made directly with the IRS. Please consult with your tax advisor and check all appropriate boxes. Notifications are retroactive to January 1 of the year the notification is received. If a notification is received after December 31, it will be applied beginning in the year that it is received.

STEP 1. ACCOUNT INFORMATION

Account Number 4 | M | V —	Account Number 4 | M | V —
Account Number 4 | M | V —	Account Number 4 | M | V —
Account Number 4 | M | V —	Tax ID Number (optional)

ALL ACCOUNT NUMBERS LISTED MUST USE SAME TAX ID NUMBER.

STEP 2. SELECT ELECTIONS OR REVOCATIONS

Election 1 – Bond Premium Amortization (Internal Revenue Code [IRC] section 171)

☐ **Yes/IRS Default:** The default assumes the client has made the election to amortize any bond premium on taxable bonds.

☐ **No/Alternative:** Pershing will not amortize the bond premium on taxable bonds.

PER IRS RULES, ALL PREMIUM ON TAX-EXEMPT BONDS WILL BE AMORTIZED USING A CONSTANT YIELD TO THE WORST CALL DATE REGARDLESS OF SELECTION.

Election 2 – Market Discount Accrual Method (IRC section 1276[b][2])

☐ **Ratable/Alternative:** Compute accruals of market discount using the ratable method.

☐ **Constant Yield/IRS Default:** The default is to accrue market discount using a constant yield method.

Election 3 – Include Market Discount as Income (IRC section 1278[b])

☐ **Yes/Alternative:** Include market discount in income.

☐ **No/IRS Default:** The default is to not include accrued market discount annually.

STEP 3. SIGNATURE

Due to the complexity of these bond elections and accrual methods, you are encouraged to consult your tax professional to determine what methods best meet your tax situation. By signing this form you are notifying your broker of the elections you have either made in the past or elections and/or revocations you will be making for all applicable covered bonds. Election notifications will be applied to all applicable covered bonds in the account during the calendar year the notification becomes effective and will be applied to all applicable covered bonds acquired in the account in future years.

Primary Account Holder Signature

Print Name	Date — —
Signature X	

Additional Account Holder Signature

Print Name	Date — —
Signature X	

BELF