

The Differences between Principal Cost, Estimated Tax Cost and NFS Cost

REFERENCE SHEET

Table of Contents

Principal Cost versus Taxable Cost Basis (eg. Estimated Tax Cost & NFS Cost)	1
Example.....	1
Principal Gain/Loss versus Principal Cost	2
Example 1	2
Example 2.....	2
Estimated Tax Cost versus National Financial Services (NFS) Cost.....	3
Estimated Tax Cost	3
NFS Cost.....	3

Principal Cost versus Taxable Cost Basis (eg. Estimated Tax Cost & NFS Cost)

Principal Cost is the sum of the purchases of a security, excluding reinvested dividends. Principal Cost is not the same as Taxable Cost Basis, as Taxable Cost Basis includes reinvested dividends.

EXAMPLE

Here is an example to illustrate the differences.

- An investor purchases \$10,000 of a mutual fund.
- Over time, \$2,000 was received in dividends that were reinvested into the fund.

Principal Cost	Taxable Cost Basis
The original \$10,000 investment (as reinvested dividends are not considered principal)	\$12,000 as the taxable cost basis includes the original \$10,000 investment plus the \$2,000 of dividends reinvested into the fund.

NOTE: Reinvested dividends get taxed upon receipt and therefore get added to the taxable cost basis upon reinvestment. Principal Cost is often used to represent the investment into that position, where tax cost represents the basis in that position for tax purposes.

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Principal Cost, Estimated Tax Cost and NFS Cost

Principal Gain/Loss versus Principal Cost

Principal Gain/Loss is sometimes used as a proxy for performance, but it can actually understate the return if dividends are not being reinvested. It is still an accurate measure of what was invested into the current position. Principal will also decline proportionally if the position is partially sold. That being said, an account's Total Principal Cost is not necessarily the total monies invested into the account, it is simply the sum of the Principal Cost of the current positions.

To illustrate the concept, below are two examples.

EXAMPLE 1

An investor puts \$50,000 into an account and invests the full \$50,000 into Microsoft. The principal is now \$50,000 both at the security level and the account level when the Principal Cost column is totaled.

A year later, Microsoft is sold for \$70,000 and the entire \$70,000 is invested into Facebook. Principal Cost will now be \$70,000 at both the security level (Facebook) and when the column is totaled.

So, Total Principal Cost is not necessarily the total original investment into the account (in this case \$50,000), it is the sum of the principal investments in the current positions.

EXAMPLE 2

Same initial principal transaction is used; an investor puts \$50,000 into an account and invests the full \$50,000 into Microsoft.

A year later, instead of selling all shares of Microsoft, half the shares (now worth \$35,000) are sold and the proceeds are used to buy shares of Facebook.

The Principal Cost for Microsoft is now reduced to \$25,000 (50% of \$50,000), while Facebook's Principal Cost is \$35,000.

In this case, the account-level Principal Cost, which is the sum of the principal investments in the current positions, is now \$60,000. It's comprised of the original principal (\$50,000) and the \$10,000 realized gain from the partial sale of the Microsoft position which then became principal as part of the Facebook purchase.

Principal Cost, Estimated Tax Cost and NFS Cost

Estimated Tax Cost versus National Financial Services (NFS) Cost

In contrast to Principal Cost, there are two kinds of taxable cost basis on the Advisor360 platform - Estimated Tax Cost and NFS Cost.

- Estimated Tax Cost is the cost basis that is calculated within Advisor360's portfolio accounting system through which transactions are posted and processed.
- NFS Cost is cost basis that is received through a static feed on NFS accounts only.

Below are the pros and cons to each type of tax cost:

ESTIMATED TAX COST

- Calculated on all accounts in the portfolio accounting system, not just NFS accounts.
- Can be viewed at the lot level as well as at the total position level.
- Gets revised historically when historical positions change due to things like dividends reinvested today as of a prior date or transactions that are cancelled or re-processed at a different price.
- May not always match the official cost basis that is calculated by the custodian.

NFS COST

- Doesn't apply to all accounts in the portfolio accounting system, only applies to NFS accounts.
- Is not provided on a lot-level basis, so is only applicable to the entire position.
- Is static and doesn't get revised historically, so it can't be displayed as of a prior date, only as of yesterday.
- Is the official cost basis as calculated by NFS.

NOTE: Both Estimated Tax Cost and NFS Cost are included in Client360°, but only Estimated Tax Cost is included in Investor360°. NFS Cost was excluded from Investor360° because it might be confusing to clients to see potentially two different cost basis calculations. Estimated Tax Cost applies to all accounts while NFS Cost does not, and Estimated Tax Cost can be viewed historically while NFS Cost cannot. For these reasons, Estimated Tax Cost was prioritized over NFS Cost in Investor360°.