

Correctly determining the cost basis of your shares is essential for properly calculating your capital gain or loss on **Schedule D** of your federal income tax return.

The Internal Revenue Service (IRS) allows you to choose which method you use when calculating your cost basis. Two commonly used methods are:

- **First-In, First-Out (FIFO)**
- **Average Cost (Single-Category)**

It is important to know the advantages and disadvantages of using each method because **once you begin using a method for a particular fund, you cannot change methods without prior approval from the IRS.** However, you may use different methods for different funds. To calculate your cost basis, you will need **Form 1099-B** and your year-end **Investor Statements.**

We have provided examples of the FIFO and Average Cost (Single-Category) methods. Please refer to the figures in the following table for each example.

History of Sample Account Equity Fund (Legacy Class A Shares)					
		Principal	Price	Shares	Cumulative Shares
07/12/07	Purchase	\$1,000	\$50	20.000	20.000
08/09/07	Purchase	\$1,000	\$53	18.868	38.868
05/02/08	Purchase	\$5,000	\$51	98.039	136.907
12/24/08	Reinvested Dividend	\$45	\$52	0.865	137.772
<b>TOTALS</b>		<b>\$7,045</b>			<b>137.772</b>
		Proceeds	Price	Shares	
12/29/08	Partial Redemption	\$500	\$55	9.091	

*(Prices and dates indicated are hypothetical.)* This chart will be used to illustrate example calculations for each method.

**For more information on the calculation of cost basis, see IRS Publication 564 – Mutual Fund Distributions. As cost basis and capital gain (loss) calculations are complex, it is important to consult your tax advisor regarding these issues.**

**First-In, First-Out (FIFO)**

When using the FIFO method, the first shares purchased are considered the first shares redeemed. The oldest shares still available are considered the first ones sold. If you do not specify a method, the IRS will assume you used the FIFO method.

**Example:**

We will use our Equity Fund example to determine the cost basis when using the FIFO method. We will sell the first shares owned, which are the shares purchased on July 12, 2007. This will be a long-term capital gain because the shares were held for longer than one year.

(1)	9.091	number of shares redeemed on 12/29/08	(2)	\$500.00	proceeds from redemption on 12/29/08
	<u>x \$50.00</u>	purchase price on 07/12/07		<u>- \$454.55</u>	cost basis of shares sold
	\$454.55	cost basis of shares sold		\$45.45	long-term capital gain

*(Note: 10.909 shares remain in the account from the 7/12/07 purchase at a purchase price of \$50.00.)*

To determine the holding period used to calculate whether gains or losses are long-term or short-term, use the FIFO method. In this example, shares purchased on July 12, 2007, are redeemed; therefore, the gain is a long-term gain.

**Average Cost (Single-Category)**

With this method, you determine the average cost of all shares held at the time of the redemption. The amount of time the shares were held before the sale is not taken into account.

**Example:**

We will use our Equity Fund example to determine the cost basis when using the Average Cost (Single-Category) method.

(1)	\$7,045.00	/	137.772	=	\$51.14
	total cost	/	total shares	=	average cost basis per share
(2)	\$51.14	average cost basis per share	(3)	\$500.00	proceeds from redemption on 12/29/08
	<u>x 9.091</u>	number of shares redeemed on 12/29/08		<u>- \$464.91</u>	cost basis of shares sold
	\$464.91	cost basis of shares sold		\$35.09	long-term capital gain

State Farm Mutual Funds has calculated your average cost basis using the Average Cost (Single-Category) method for most non-tax-qualified account fund positions that were opened after 1978. The results of this calculation appear on your **Form 1099-B**. If "N/A" appears in the Gain (Loss) area, we were unable to provide the calculation for the account.

Holding Period: Please note, the characterization of the gain/loss is determined by using the FIFO method. Shares held for one year or less are considered short-term and are designated as "short" (S) on **Form 1099-B**. Shares held for more than one year are considered long-term and are designated as "long" (L) on **Form 1099-B**. Please refer to the instructions for **Schedule D (Form 1040/1040A)** for more information on the tax treatment of gains and losses based on the length of time your shares were held.

You can use the Average Cost Basis calculated on your **Form 1099-B** only if:

- 1) you have used the Average Cost (Single-Category) method for calculating your cost basis on previous redemptions or exchanges from the same fund, or
- 2) this is your first redemption or exchange, and you elect to use the Average Cost (Single-Category) method.

**Reminder:** You must state on your income tax return which method you have chosen, or the IRS will assume you are using the FIFO method.

An important point to keep in mind as you are calculating your cost basis is that reinvested dividends and capital gains should be included in your cost basis. Any increase in cost basis will decrease your taxable capital gains, or increase your capital losses.

Capital losses may be beneficial to you as they generally may be used to fully offset other taxable capital gains. For individuals, if capital losses remain after offsetting capital gains, they may be able to be used to offset up to \$3,000 of ordinary income for the current year.

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**This information should assist an individual who is a citizen or resident of the United States with filing their 2008 federal and state income tax returns, but it is not intended to serve as legal or tax advice. For any specific tax questions, you should contact the Internal Revenue Service (IRS) at 1-800-829-1040, or consult your tax advisor.**

Tax forms will be mailed to shareowners at the end of January 2009. Your individual tax information can be viewed prior to the actual tax form being mailed when you access your account under the Mutual Funds tab on statefarm.com®. Planning ahead is important during tax season. Allocate enough time to provide a cushion for unexpected situations that may arise (e.g., mail delays). It is a good idea to keep all of your year-end records for each year that your account is open. This will allow you to access your information without any delay. To request a duplicate year-end 2008 record or tax form to be mailed to your address of record, please call us at 1-800-447-4930. It will take a minimum of five days to receive your duplicate record.

**At State Farm Mutual Funds, representatives in our Securities Response Center are ready to assist you. However, due to the tax season, we anticipate heavy call volumes during the majority of our regular business hours: 8:00 a.m. to 6:00 p.m. CT Monday through Friday. Your call is important to us, and we look forward to providing you with the best service possible.**

**Securities Response Center: 1-800-447-4930**

**Securities through registered representatives of State Farm VP Management Corp., One State Farm Plaza, Bloomington, IL 61710-0001 (1-800-447-4930). Investment return and principal value will fluctuate and your investment, when redeemed, may be worth more or less than its original cost.**

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