



FAIRHOLME FUNDS, INC.

SHARES DISTRIBUTED BY
FAIRHOLME DISTRIBUTORS, INC.
MEMBER FINRA

FAIRHOLMEFUNDS.COM

Important Information Regarding Cost Basis Regulations and Your Account

Dear Shareholder,

The Energy Improvement and Extension Act of 2008 requires mutual funds to provide Cost Basis and holding period reporting to both the Internal Revenue Service (IRS) and shareholders for gross proceeds from purchases acquired and sold on or after January 1, 2012.

We would like to take this opportunity to provide you with some background on what you can expect with regards to these new Cost Basis requirements.

- Cost Basis reporting will be required on shares purchased on or after January 1, 2012 (“covered shares”).
- Cost Basis reporting is not required on shares purchased before January 1, 2012 (“non-covered shares”).
- Beginning with the 2012 tax year, your 1099B forms will provide you with Cost Basis and character of gain/loss (short-term vs. long-term) information. This information will be reported to you and to the IRS for covered shares.
- Cost Basis reporting does not apply to Retirement accounts, C Corporation accounts or Exempt Organization accounts.
- For the 2012 tax year, any non-covered shares you redeem will continue to be reported to you as a service, but the Fund is not required to report this information to you or the IRS.
- **Please note that The Fairholme Funds, Inc. has chosen the Average Cost method as the default tax lot identification method for its shareholders who do not select an alternative method.**

Cost Basis Methods

Fairholme Funds, Inc. will offer you the option to choose one of the following Cost Basis calculation and depletion methods:

AC (Average Cost)	Shares are depleted on a first in/first out basis with the Cost Basis calculated by taking the shares redeemed multiplied by the average cost per share.
FIFO (First In, First Out)	Oldest shares acquired are first redeemed.
LIFO (Last In, First Out)	Most recent shares acquired are first redeemed.
HIFO (Highest Cost, First Out)	Shares with highest Cost Basis are redeemed first.
LOFO (Lowest Cost, First Out)	Shares with lowest Cost Basis are redeemed first.
HILT (Highest Cost Long Term, First Out)	Will redeem the long-term highest cost available shares first.
HIST (Highest Cost Short Term, First Out)	Will redeem the short-term highest cost available shares first.
LILT (Lowest Cost Long Term, First Out)	Will redeem the long-term lowest cost available shares first.
LIST (Lowest Cost Short Term, First Out)	Will redeem the short-term lowest cost available shares first.
Specific Lot Depletion *	The lots to be depleted are specifically chosen by you at the time of redemption.

**When selecting Specific Lot Depletion method, please note that the Average Cost method will be used as an alternate in the event that the Specific Lot Depletion information is not provided.*

Ignore the crowd.

How to Elect a Cost Basis Method

If you wish to elect a standing method other than our default of Average Cost, please fill out the attached Cost Basis Election Form and return to:

By Regular Mail:
Fairholme Funds, Inc.
PO Box 9692
Providence, RI 02940-9692

By Express Mail or Overnight Courier:
Fairholme Funds, Inc.
4400 Computer Drive
Westborough, MA 01581-1722

Please note that if you elect a Cost Basis method other than Average Cost, the regulations require that you make the election in writing.

Also note that if you elect the Average Cost Basis method, you will be allowed to revoke your election by the first disposition of the shares. Thereafter, you may change from the Average Cost Basis method at any time, but only for shares acquired after the date of the change (the change is prospective). After the change, the basis of the shares that was averaged remains averaged.

This election is good for all future transactions unless you either revoke or change the standing election. You may also choose the method to be used at the time you request to redeem shares. Please note that any change from or to the average cost method would need to be in writing.

When you Redeem Shares

When you redeem shares from your account, we will deplete shares and calculate the Cost Basis on those shares according to your Cost Basis method election. If you do not designate the Cost Basis reporting method to be used prior to or at the time of your redemption, the trade will be processed using our default method of Average Cost.

Tax Reporting

If you redeem covered shares from your account during 2012, the Form 1099B that you and the IRS will receive in 2013 will provide Cost Basis information specific to the covered shares redeemed. As a service to you, we will continue to report any cost basis information we have on non-covered shares for informational purposes only, but this is not required by the IRS.

We strongly encourage that you consult your tax adviser if you have any questions about your Cost Basis reporting options. Information can also be obtained by visiting the IRS website at www.irs.gov.

If you have any questions, please contact one of our customer service representatives at 1-(866)-202-2263 Monday through Friday between 8a.m. and 8p.m. Eastern Standard Time.

Sincerely,

Fairholme Funds, Inc.

Fairholme Funds, Inc.

COST BASIS ELECTION FORM

Account Title: _____ Account Number: _____

IRS regulations require Fairholme Funds, Inc. to report Cost Basis on mutual fund shares purchased after January 1, 2012. Please complete this form to elect or change your Fairholme Funds, Inc. Cost Basis reporting method(s).

NOTE: If you do not make an election, Fairholme Funds, Inc. will apply its default method, which is the Average Cost method, to your account. We recommend that you consult your Tax Advisor and/or Financial Professional before making important tax elections for your taxable account(s).

Please choose ONE Cost Basis reporting method from the list of reporting methods below by marking an X in the appropriate box. This selection will apply to each fund position in the account referenced above. If you wish to choose a different method for each fund, please attach a letter of instruction with this form detailing your selections. (Cost Basis reporting does not apply to retirement accounts, C corporations and exempt organizations)

- | | | | | |
|----------------------------------------------|----------------|-----|--------------------------|------|
| 1. Average Cost (AC) * | (Fund Default) | 1 | <input type="checkbox"/> | [AC] |
| 2. First in, First Out (FIFO) | | 2 | <input type="checkbox"/> | [FI] |
| 3. Last in, First Out (LIFO) | | 3 | <input type="checkbox"/> | [LI] |
| 4. High Cost, First Out (HIFO) | | 4. | <input type="checkbox"/> | [HI] |
| 5. Lowest Cost, First Out (LOFO) | | 5. | <input type="checkbox"/> | [LO] |
| 6. Highest Cost Long Term, First Out (HILT) | | 6. | <input type="checkbox"/> | [H1] |
| 7. Highest Cost Short Term, First Out (HIST) | | 7. | <input type="checkbox"/> | [H2] |
| 8. Lowest Cost Long Term, First Out (LILT) | | 8. | <input type="checkbox"/> | [L1] |
| 9. Lowest Cost Short Term, First Out (LIST) | | 9. | <input type="checkbox"/> | [L2] |
| 10. Specific Lot Depletion (SLDM) ** | | 10. | <input type="checkbox"/> | [SL] |

* Please note that if you elect the Average Cost method, you would be allowed to revoke your election by the first disposition of the shares. Thereafter, you may change from the Average Cost method at any time, but only for shares acquired after the date of the change (the change is prospective). After the change, the basis of the shares that was averaged remains averaged.

** Please note that if you choose this method you will need to identify the lot(s) at the time of your redemption request. If you do not, the redemption will be processed using the Average Cost method.

By signing below, I/we certify that I/we am/are authorized to make this tax election. I/we understand that Fairholme Funds, Inc. does not provide tax advice and is not responsible for the election(s) I/we am/are making for my/our account(s).

Signature #1 _____ Date: _____

Signature #2 _____ Date: _____

If you have any questions about this form, please call 1-(866)-202-2263 Monday through Friday between 8:00 a.m. and 8:00 p.m. Eastern Time. Please keep a copy of this Election Form for your files.

Please return completed form to:

By Regular Mail:
Fairholme Funds, Inc.
PO Box 9692
Providence, RI 02940-9692

By Express Mail or Overnight Courier:
Fairholme Funds, Inc.
4400 Computer Drive
Westborough, MA 01581-1722