

Burden Reduction Subgroup Report

A. Cost Basis Proposed Regulations for Debt and Options

Recommendations

Through its public comment letter and subsequent interactions with the IRS, IRPAC has recommended a variety of measures to be considered in formulation of final regulations regarding cost basis reporting for debt instruments and options. The highlights of these recommendations are as follows:

HARMONIZE REPORTING FOR BASIS AND INCOME

Implicit in the cost basis for debt are elements of income such as bond premium and original issue discount. Due to inadequate availability of information and other restrictions, there have always been limits to the requirements for reporting income. Even though these limits exist, the proposed regulations assumed them away. IRPAC therefore has recommended that these circumstances be reviewed to ensure that well established and long recognized industry capabilities and circumstances are honored and given due consideration in the formulation of cost basis reporting requirements.

1. Tax exempt original issue discount

Since 2006 payees have not been required to report tax exempt Original Issue Discount (OID) to payees until further guidance is forthcoming from the IRS. Additionally, where capabilities exist to compute these amounts it is limited to issues that have amounts of OID beyond the de minimis threshold as would be measured for taxable instruments. IRPAC recommends that basis reported for tax exempt discount instruments be optional until such time as these issues are addressed and industry has been given ample time to implement any required systematic changes.

2. Treasury Separate Trading of Registered Interest and Principal Securities (STRIPs)

Reporting of OID income on Treasury STRIPs may be done based on a table of income approximations available in Publication 1212 Guide to Original Issue Discount. These amounts are recognized as likely to differ from the payee's actual income and, therefore, adjustment to basis.

EXCLUDE ADDITIONAL TYPES OF SECURITIES FROM THE DEFINITION OF COVERED SECURITY

Some types of debt instruments have basis computation requirements that differ from traditional debt. Due to this complexity IRPAC recommends that the following types of instruments be considered for inclusion in the definition of covered securities only after reporting for traditional debt obligations has been well established.

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1. Contingent payment debt
2. Structured products containing debt
3. Inflation protection securities

ADJUSTED BASIS AT THE TIME OF TRANSFER

1. **Required elements for transfer statements**

The proposed regulations have a large number of data elements that are to be included in transfer statements for debt instruments. IRPAC has recommended limiting this list only to items needed to continue schedules of accretion and amortization from the adjusted basis as of the transfer date.

2. **Working from adjusted basis rather than recomputing**

Two approaches can be used when receiving a position in a debt security through a transfer. The recipient can either compute any premium or discount based on the original purchase date and price or evaluate the position by comparing the adjusted basis to the adjusted issue price on the transfer date. IRPAC has recommended the latter approach for several reasons.

3. **Wash sale adjustments would not be captured**

The impact of wash sale adjustments to the original transaction will not necessarily be captured if the transferor must go back to the beginning of the tax lot's history. On the other hand, the adjusted basis as of transfer date should reflect the impact of such activity.

4. **Respects the prior year reporting of income**

If there are differences in the computation routines used by the transferor or transferee, recomputing from the tax lot's inception would potentially imply changes to income recognized by the taxpayer in prior years.

5. **No material difference**

If both parties use identical methodology there will be no material difference and if the computations for initial years were faulty, the successor, picking up at the reported adjusted basis, has the opportunity to put income recognition and basis adjustment on a proper path for the duration of the tax lot's life.

HAVE INFORMATION REPORTING FOR OPTIONS STRUCTURED THE SAME WAY AS DEBT OR EQUITY

Proposed regulations established a routine in which the net gain or loss for cash settled options was reported rather than a traditional basis and proceeds approach that is familiar to taxpayers. IRPAC has recommended an approach more consistent with the treatment of equities because this is complementary to the taxpayers responsibility with regard to Form 8949 Sales and Other Dispositions of Capital Assets and Schedule D Capital Gains and Losses as well as matching the way the transactions are captured by existing industry practice. To make information returns more consistent with the nature of the financial instrument, it was further

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recommended that the 1099-B Proceeds From Broker and Barter Exchange Transactions designation of “Cost or other basis” be modified to “Basis or cost to open or close.”

DISTINCT GUIDANCE FOR EQUITY AND NONEQUITY OPTIONS

The single approach to options envisioned by the proposed regulations does not address the fact that the tax treatment of options under section 1256 does not require either a determination of long- or short-term or a traditional gain/loss recognition based on purchase cost. IRPAC has recommended that distinct and different approaches be considered for equity and non-equity options. Further consideration must be given to the existing capabilities of the industry’s existing systems.

MODIFICATIONS TO FORM 1040 SCHEDULE D

Information regarding sale of financial assets generally flows from Form 1099-B to the Form 8949 to Schedule D of Form 1040 U.S. Individual Income Tax Return. There is a special provision on Schedule D to account for the fact that collectibles are taxed at a different rate than capital gains for other financial instruments. There is no similar provision; however, to segregate assets that are reported to the payee on Form 1099-B, but also require treatment that is other than usual capital gains. For several types of assets, there is no capital gain or loss. Rather, the closing transaction results in ordinary income or loss which is accounted for elsewhere on Form 1040. Accordingly, Schedule D requires a mechanism to properly treat:

1. Currency shares and other issues subject to Section 988
2. Contingent payment debt instruments

Discussion

IRPAC’s comment letter of February 2012 goes into great detail on these issues and others. Both prior to and following the comment period, there have been productive sessions that have enabled both the IRS and IRPAC to explore the implications of these issues and to address other matters that have been found in the industry. Appendix F to the public report contains the public comment letter as well as other recommendations provided in an IRPAC Cost Basis follow-up correspondence.

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B. Substitute Information Returns

Recommendations

PUBLICATION 1179 GENERAL RULES AND SPECIFICATIONS FOR SUBSTITUTE FORMS 1096, 1098, 1099, 5498, AND CERTAIN OTHER INFORMATION RETURNS

Financial institutions that are required to file forms 1099 and other information returns are permitted to create substitute versions of these forms within the guidelines of Publication 1179 (or its concomitant revenue procedure) issued annually by the IRS. Modifications are made to this document annually, but over time, the publication has not received a thorough overhaul that is required by technological changes and the realities of the marketplace. In fact, IRS asked IRPAC for “assistance in updating, streamlining, and simplifying” the publication. In addition to the observations shared in meetings throughout the year, IRPAC furnished a marked up copy of the current publication draft that focused on the following modifications and recommendations.

- 1. Eliminate distinction between substitute and composite statements.**
There are subtle differences pertaining to substitute forms as opposed to a conglomeration of several substitutes in a single document. The reasons for these differences are unclear and they generally lead to uncertainty in creation of comprehensive tax statements that financial institutions would like to supply to their customers.
- 2. Concentrate on specifying what information is required rather than formats.** The publication includes directives to do things such as present data elements in the numerical order of the box numbers on the official form. This is impractical and ill conceived; in 2012, for example, an item on form 1099-B was numbered “1c” when it had been “15” on the prior year’s form. This type of annual shuffling and renumbering of boxes is confusing and cumbersome to both the filer and recipient of the form. Taxpayers generally prefer the information on their tax statements to follow the same flow as their monthly (or other applicable period) statements.
- 3. Eliminate multiple references to the same requirements to reduce ambiguity.** In 2011 there were three different areas of the publication that governed the IRS legends that should appear on form 1099-B. IRPAC’s revisions reduced this to one.
- 4. Allow for all boxes of Form 1099-MISC Miscellaneous Income to appear on a composite form.** When a filer creates a composite form, only some types of income from Form 1099-MISC may be included in the document. Therefore, when certain trusts make distributions of interest and rent, for example, only the interest may appear on the composite form, with the rent relegated to a separate document.

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5. **Eliminate the reference to “Copy B.”** When multipart paper forms were prevalent, the various form layers were given alphabetic designations. The publication still requires that a payee copy carry the “Copy B” designation although no other paper copies actually exist. This is confusing and prompts unnecessary questions. When only one copy of a form is delivered to the payee and the payer files electronically with the IRS, the “Copy B” designation should not be required.
6. **Avoid superfluous repetitions.** With the advent of cost basis reporting, the IRS has required that amounts reported on substitute Forms 1099-B be organized according to term (long or short) and whether basis is reported to the IRS. Additionally, an indication of status (covered or noncovered) is required. Since the official form includes these items for each reportable amount it should be clear that where the substitute is organized within sections that bear these data elements in the title, they do not have to be repeated with each line item.
7. **Clarify the use of logos.** Publication 1179 should be clear that logos are permitted on permissible enclosures within the same guidelines as payee statements.
8. **Permit inclusion of modern equivalents.** The name and address of the payer is required on the substitute forms along with a contact phone number. It should be specified that additional information such as an email address or web URL that would guide the payee to the same contacts or a repository of additional relevant information is permissible on payee statements.

STATE TAX WITHHOLDING

Provisions for reporting state income tax withholding on Forms 1099 were added for tax year 2012. There are some limitations and inconsistencies to these new form boxes.

1. **State tax reporting boxes on 1099-MISC.** The presentation on this form is inconsistent with the equivalent boxes on Forms 1099-DIV Dividends and Distributions, 1099-INT Interest Income, 1099-B and 1099-OID Original Issue Discount. The wording differs and a single box is used for the state and state ID number. This should be harmonized with the other forms.
2. **Withholding in multiple states.** For the instances in which withholding has been deposited in more than one state, guidance should explicitly state that the use of the word “Various” is proper and supplemental reporting of the applicable details to the payee is encouraged. This would also be consistent with the approach used to convey foreign tax withheld on the same forms.

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Discussion

Over the past several years, IRPAC has had the opportunity to provide important input to the IRS with regard to substitute forms. This was particularly true with the changes required by the initial cost basis reporting requirements. This process has continued for the current year as we have provided substantial changes to the draft of Publication 1179 to address deficiencies and future needs. We have welcomed this opportunity and look forward to the continued collaboration.

C. Reporting Tax Credits on Form 1097-BTC Bond Tax Credit

Recommendations

1. PUBLISH SUBSTITUTE STATEMENT REQUIREMENTS SEPARATELY FROM PUBLICATION 1179

Form 1097-BTC is a new form that has a quarterly reporting requirement to payees. Therefore, IRPAC has recommended that guidance for substitute statements be published separately from Publication 1179, the traditional repository of that information.

2. ELIMINATE ALLOWANCE DATES IN FAVOR OF A CALENDAR MONTH

Early drafts of Form 1097-BTC required reporting the tax credits associated with specific quarterly allowance dates and an additional box for anything falling outside those dates. This arrangement could have required filers to issue multiple forms in certain circumstances. IRPAC has recommended that a total of credits for each calendar month be adopted instead.

3. LIMIT THE FREQUENCY OF REPORTING TO QUARTERLY

Form 1097-BTC provides payees with the value of tax credits earned throughout the year. Although the form provides the amounts applicable to each calendar month, IRPAC has recommended that reporting be limited to the end of each calendar quarter.

4. PUBLISH GUIDANCE ON CORRECTION PROTOCOLS

Since this form must be provided to payees quarterly, IRPAC has requested that the IRS provide guidance on how corrections should be provided. Should they appear on the subsequent quarter's report? As a separate document? Would the annual report to the IRS be considered "corrected" under such circumstance?

5. REPLACE THE UNIQUE IDENTIFIER

Initial drafts of Form 1097-BTC required a unique identifier (created by the filer) that would be associated with each credit allowance date on each form. IRPAC has recommended the use of a single unique identifier associated with each account.

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6. USE PLAIN LANGUAGE LABELS INSTEAD OF CRYPTIC NUMERIC DESIGNATIONS.

Form 1097-BTC has a box for bond type. The current requirements are to populate the box with a value of 101 for Clean Renewable Energy Bonds (CREB) and 199 for any other type of tax credit bond. IRPAC recommends that the bond be identified as either CREB or non-CREB since a taxpayer is more likely to recognize a description of the asset owned than the numeric designation.

Discussion

The form and instructions posted in late August incorporate many of the committee's recommendations. Unfortunately, since the series 1097 was used for this new form rather than 1099, the provisions of Taxpayer Identification Number (TIN) truncation that were established by Notices 2009-93 and 2011-38 do not apply to this new form. This is probably an unintended consequence that the IRS should consider addressing expeditiously.

D. *De minimis* Threshold for Form 1099 Corrections

Recommendation

In an effort to reduce overall burden to information return filers, taxpayers and the IRS, IRPAC recommends that the IRS adopt a *de minimis* dollar threshold for corrections to information returns. IRPAC specifically recommends a threshold of

\$50 be adopted so that net changes of \$50 or less (up or down) do not require the filing of a corrected information return. Regulatory changes under IRC §§ 6721 and 6722 should be considered so that filers of Forms 1099 have clear authority for suppressing these immaterial corrections. Specifically, a failure to correct a *de minimis* amount of previously reported income should be defined as an "inconsequential error" that is not subject to the penalty provisions of IRC §§ 6721 and 6722.

Discussion

Currently, in instances where information returns and payee statements are found to contain an error, substantial resources are being expended by withholding agents, including financial institutions (for printing, mailing, reputation, etc.), taxpayers (for filing amended returns), and the IRS (for processing and data matching, etc.) to correct and process corrected statements that, in many cases, have no impact on tax liability. This burden on resources is unnecessary when the correction is for an inconsequential sum that changes neither the taxpayer's liability nor the Government's revenues.

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An actual industry example, as set forth in Appendix G, has been provided to the Service as evidence of the impact of a *de minimis* dollar threshold for corrections. In this example, for this particular brokerage firm, 5150 accounts were held in a particular a Unit Investment Trust (UIT) in 2009. The 2009 Forms 1099-DIV, Dividends and Distributions, issued to those accounts included income attributable to that UIT. In the first quarter of 2011 (nearly a year after the associated income tax returns of UIT account holders would have been filed), the trustee's accounting firm discovered an error in the factors that the trustee had supplied to the industry allocating its distributions between dividend and non-dividend distributions for information return reporting. The trustee published amended factors that required corrected Forms 1099-DIV. The chart shows the distribution of those accounts across various dollar correction levels. If corrections were not required for changes of \$50 or less, nearly 45% of the corrections could have been avoided - and at no loss of revenue to the Government.

In instances involving large scale corrections where a filer discovers a systemic problem or faulty data source, there is often a desire to create some sort of settlement between the financial institution and the IRS to avoid the inconvenience to customers of amending payee statements. This desire to avoid amended statements increases as the time between the original statement and potential correction increases.

Further, the IRS has already recognized the need for certain *de minimis* exceptions, and IRPAC believes that the IRS should recognize that this is an additional area where a *de minimis* exception makes sense. Treasury Regulation § 301.6721-1(d) already permits an exception for a *de minimis* number of failures to include correct information on certain information returns if certain criteria are met. Unfortunately, it falls short of remedying the issue at hand as it does not offer a *de minimis* dollar amount exception for corrections.

In response to the IRS's request for burden reduction assistance, IRPAC has forwarded this issue to Chief Counsel for possible inclusion in the 2013 Priority Guidance Plan. Further, IRPAC has discussed the need for a *de minimis* threshold amount with The National Taxpayer Advocate, Nina Olson, and her staff.

This is not a new issue, and the lack of guidance in this area has created a long history of on-going concerns and wasted resources. Everyone involved in the process, including issuers, recipients and processors of information returns would be well served by the IRS putting a protocol in place to reduce the number of unnecessary corrected filings.

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E. Third Party Agent Reporting Using Form 2678, Employer/Payer Appointment of Agent

Recommendation

IRPAC recommends that the IRS clarify the liability of an agent reporting using Form 2678 such that the agent is only responsible for the acts authorized by the employer. IRPAC recommends that the IRS also provide more detailed and updated instructions for an agent who reports and deposits backup withholding taxes for payers under § 3.02 of Rev. Proc. 84-33.

Discussion

An agent who is authorized by an employer to pay the wages of the employer's employees generally has the same withholding tax liability as the employer. When the agent is authorized to pay only a portion of the wages to some of the employees, then the agent should only be responsible for withholding taxes with respect to the wages it paid, not all of the wages of the employer. Prop. Reg. § 31.3504-1(a), Third Party Arrangement Chart on www.irs.gov, and instructions to Form 2678 should be revised to clarify this limitation. Form 2678 should provide space for employer to specify the particular type or portion of wages and compensation for which the agent is responsible.

In addition, the instructions to Form 2678 refer to Rev. Proc. 84-33, which allows an agent to deposit backup withholding taxes on behalf of a payer. Rev. Proc. 84-33 should be updated, and Form 2678 should also have more detailed and updated instructions, for an agent who reports and deposits backup withholding taxes for payers under § 3.02 of Rev. Proc. 84-33. This updated information should cover the withholding aspect of all relevant forms in the 1099 series.

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