Appendix A
IRPAC Comments on Notice 2009-93 Taxpayer Identification Number Truncation
(December 17, 2009)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

December 17, 2009

Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-93)
Room 5203
P.O. Box 7604
Ben Franklin Station, N.W.
Washington, DC 20044

Re: Notice 2009-93 Taxpayer Identification Number Truncation

To Whom It May Concern:

On behalf of the Information Reporting Program Advisory Committee (IRPAC)[1], we submit the following comments on the issue of Identity Theft and Privacy in response to Notice 2009-93.

Over the past two years, IRPAC presented proposals regarding the masking of Taxpayer Identification Numbers (TINs) on payee statements in order to protect taxpayer information and prevent identity theft. Based on those recommendations we are pleased with the work of your office and the release of Notice 2009-93 (the "Notice"). We believe the pilot program makes great strides towards addressing the issue of identity theft. However, as discussed in our meeting with counsel on December 2, 2009, we strongly encourage the following changes to the program.

Support for Truncation of Employer Identification Numbers (EIN)

Our most important suggestion is that the IRS should permit payors to truncate EINs on payee statements.

The Notice allows truncation for TINs issued to individuals (SSNs, ITINs, etc.), but not for EINs which are issued to entities. Thus, a payor is required to distinguish EINs from other types of TINs in order to participate in the pilot program.

The requirement to distinguish EINs from other types of TINs is preventing payors from participating in the pilot program. Payors have historically not been required to determine

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[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

the type of TIN they receive from a payee. In fact, many payors do not currently know the type of TIN they have on file for each payee, and are unprepared for the sudden emergence of this new requirement.

IRPAC recognizes that identity theft poses a greater risk to individuals than it does to entities, which is apparently why the Notice only allows truncating TINs that are issued to individuals. However, prohibiting EIN truncation seemingly serves little or no purpose but to prevent payors from participating in the pilot program

IRPAC believes strongly that EIN truncation should be permitted, and believes it important enough that Notice 2009-93 should be revised to allow EIN truncation for all years of the pilot, including tax year 2009 reporting in 2010. This change would allow for wider participation in the pilot program, which would give IRS better data when analyzing the ultimate move from a pilot to full production.

Support Truncation on Electronically Delivered Statements

Our second critical comment looks to reverse the electronic delivery disallowance. Notice 2009-93 supports truncation on paper delivery and explicitly disallows it on electronic delivery. IRPAC recommends that truncation be allowed on electronic delivery of forms as well as paper delivery for the following reasons: difficulties in developing payee statements using two modes, market discrimination in imposing a rule that supports some payers and not others, and most importantly, identity theft is a real threat in e-delivery. Identity theft presents a great risk in both delivery modes. The IRS has done a very thorough job of developing requirements for securing the electronic delivery of information reports. The truncation of TINs would complete those requirements.

Payors develop the 1099 payee statements through a separate software program or service that pulls from a central processing system. The program that generates statements is independent from the program used to prepare the data for the file that is transmitted to IRS file. The only exceptions are small payors who file paper 1099s from the same operation. Whether the payee statement is developed for shipment to a print facility or set up for electronic delivery, the process for most payors is the same. By limiting the truncation to hard copies, it will make the development process more complex. Changing the requirements of one output and not the other will cause payers to create a separate process for paper mailings that many may not be able to do and it will limit participation in the pilot program.

In addition, many large payers solely function in eservices. There are eservice brokers, banks, and other financial institutions that will not be able to use this process for most of their clients who currently accept edelivery of their 1099s by their choice. Paper statements in their world are very rare making the rules as written a market constraint for them as well as putting them at a competitive disadvantage.

IPRAC also believes that there is a significant reason to truncate TINs in electronic delivery to avoid identity theft. Major vulnerabilities to identity theft lie in electronic delivery whether the data is stolen from a misappropriated laptop or inappropriately shared through a public server or even through public WIFI use. If the TIN was truncated, that vulnerability would be greatly reduced. IRPAC strongly recommends the extension of the TIN truncation rules to electronic deliveries as soon as possible.

Expansion of Forms Supported
IRPAC also recommends that other key forms be included in the pilot. We believe that adding Forms 3921 and 3922 to the pilot will provide for better data to evaluate the success of the pilot program.

Extension of the Pilot
Although we hope that a broader rule will be made final as soon as practical, the late delivery of Notice 2009-93 as well as its filing constraints discussed above, will substantially limit the number of payors able to participate in the pilot program. We propose that IRS modify the effective years of the pilot to include tax year 2011. These changes will provide IRS two years of complete data to evaluate the program with the broadest participation possible.

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Thank you for the opportunity to provide comments on Notice 2009-93. IRPAC believes this is an important step in the protection of taxpayer information. If you have any questions, please contact the undersigned. We look forward to working with you.

Sincerely,

Jon W. Lakritz
2009 IRPAC Chair

cc: Ms. Nancy Rose
Senior Counsel, Procedure and Administration
Office of Chief Counsel

Appendix B
IRPAC Request for Form 5500/5330 Automatic Extension for August 2, 2010 Deadline (July 8, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7559, Washington, D.C. 20224

July 8, 2010

Internal Revenue Service, TE/GE
1111 Constitution Avenue N.W.
Washington, DC

Re: <u>Request for Form 5500/5330 Automatic Extension for August 2, 2010 Deadline</u>

Dear Sir or Madam:

The Information Reporting Program Advisory Committee (IRPAC)[i] appreciates the opportunity to submit comments on the upcoming 2009 Form 5500 filing deadline of August 2, 2010. Specifically, IRPAC requests an automatic extension be given for the 2009 Form 5500, consistent with the automatic extension granted with EFAST1. As more fully described below, we strongly believe the extension will greatly enhance the accurate reporting and accurate transmittal under the new EFAST2 process and procedures, particularly for the small business plan sponsor. The extension of time will also increase plan sponsor recognition and comfort in its new role and responsibility for electronic filing of the 2009 Form 5500.

Need for Automatic Extension

An automatic extension for filing the 2009 Form 5500 and Form 5330 is needed because of the following reasons:

- The late issuance of the 5500 Form;
- The delay in vendor software;
- The time needed to assess which vendor software a service provider may consider using;
- The new process for a plan sponsor to determine whether to obtain signing credentials or provide signature to the Form 5500;
- The time to educate plan sponsors and their tax advisors;

[i] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the Internal Revenue Service consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system." Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

- The time to assist plan sponsors to obtain signing credentials; and
- The time for service providers to learn the new form, new software and create procedures to prepare plan sponsors for understanding and executing their responsibility.

Moreover, the extension is of particular concern for small business plan sponsors. Many small business plan sponsors have not previously filed electronically, do not use the Internet, and do not have the resources to use an independent service provider. In these situations, the Form 5500 is completed with little or no external assistance. With the new form and procedures, even tax professionals are grappling with issues related to the delayed issuance of the software, new processing requirements, and glitches in the software - all in combination with questions that need time to research regarding all of these new features.

Lastly, we anticipate more extensions this year than in prior years due to the new form and filing process. However, the new schedules, the new process, the new regulations relating to certain information disclosures were issued during the busiest time of year, with the Economic Growth and Tax Relief Reconciliation Act of 2001 plan document adoption deadline within the same time frame.

Recommendation

IRPAC recommends that an automatic extension be granted for a limited group of information returns:

1. 2009 calendar year plans
2. August 2, 2010 deadline automatically extended to October 15, 2010
3. Form 5558 would not be required for the calendar year filings to extend the Form 5500 or the Form 5330 deadline to October 15, 2010.

The resources used to create and process the extensions should be used to work with plan sponsors who have concerns over this new system. Many plan sponsors have concerns about not only the new filing process but that obtaining signing credentials involves more internal security than previously necessary because of the PIN procedures. Plan sponsors need more time to be acclimated to this new process and the decision to have their signature on the Internet if they allow their service provider to transmit the filing as many service providers have done in the past.

Importantly, Form 5330 is being requested as part of this automatic extension. If the Form 5500 requires extension because it has not been processed and accepted, often there is no way to determine whether a return needs to be made for the transactions reported on Form 5330. In these situations, Form 5558 is used to request this extension.

To the extent that system changes cannot be timely implemented to provide this relief, we would request that other similar relief measures be considered to address these concerns.

IRPAC appreciates the opportunity to present comments on this important issue. If you have any questions, please contact me or Lisa Germano, a member of the Employee Benefits/Payroll Sub-Group.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

Appendix C
Sample FAQ: Electronic Delivery of Form 1098-T, Tuition Statement

Appendix C

Electronic Delivery of Form 1098-T, Tuition Statement

Question: Treasury Regulation 1.6050S-2 provides that institutions required to furnish Form 1098-T may furnish the statement in an electronic format in lieu of a paper format, as long as requirements pertaining to affirmative consent, required disclosures, format, notice and access period are met. Provided that all requirements in paragraphs (a)(2) through (6) of Regulation 1.6050S-2 are met, is it acceptable for educational educations to integrate consent to electronic delivery of Form 1098-T as part of a global "Consent to do Business Electronically" agreement? A global consent agreement might cover primary institutional student business functions such as admissions, registration, Form 1098-T, billings, and direct bank deposit.

Answer: Educational institutions may present the option to **c**onsent to receive Form 1098-T electronically as part of a global "Consent to do Business Electronically", combining consent for electronic delivery of Form 1098-T along with other institutional student business functions such as admissions, registration, billings and direct deposit. The global consent process must meet all of the consent, disclosure, format, notice and access period requirements for electronic furnishing of Forms 1098-T as required by paragraphs (a)(2) through (6) of Treasury Regulation 1.6050S-2.

Additional Information:

http://www.irs.gov/pub/irs-pdf/i1098et.pdf

Appendix D
Announcement 2010-41: New Backup Withholding Procedures: Social Security Number Validation following Receipt of Second B Notice

Appendix D

Announcement 2010-41

New Backup Withholding Procedures: Social Security Number Validation following Receipt of Second B Notice

PURPOSE

The Internal Revenue Service ("IRS") is announcing a change in procedures for individual payees to follow to obtain validation of social security numbers ("SSNs") from the Social Security Administration ("SSA") to prevent or stop backup withholding under section 3406 of the Internal Revenue Code following receipt of a second "B notice" from a payor.

BACKGROUND

Pursuant to section 3406 and the regulations thereunder, a payor (such as a bank) must send certain notices under section 3406(a)(1)(B) ("B notices") to a payee after being notified by the IRS or a broker that the payee has provided an incorrect name and taxpayer identification number ("TIN") combination with respect to an account. Following the first notification from the IRS or broker, the payor must send a first B notice to a payee directing the payee to certify the TIN on Form W-9 in order to stop or prevent backup withholding on reportable payments by the payor. If the payor receives a second notice of incorrect TIN from the IRS or broker within three years, the payor must send a second B notice to the payee requiring the payee to provide TIN validation. After the second B notice, the payor cannot accept a TIN certification on Form W-9 but must receive validation of the payee's TIN from the SSA or the IRS. Absent receipt of proper validation, the payor must backup withhold from future reportable payments it makes to the payee.

The rules concerning the form, content and manner of delivery of B notices are set forth in Rev. Proc. 93-37, 1993-2 C.B. 477. That revenue procedure sets forth specific instructions regarding TIN validation, which must be included in the second B notice sent to payees. Pursuant to the instructions in Rev. Proc. 93-37, a payee who needs to validate an SSN must contact the local SSA office to inquire about SSN validation, provide a copy of the B notice to SSA, and request and authorize SSA to send Form SSA-7028, *Notice to Third Party of Social Security Number Assignment*, to the payor to validate the payee's SSN.

Effective January 1, 2010, SSA discontinued the availability of Form SSA-7028 for purposes of verifying SSNs to avoid backup withholding. This announcement updates the instructions for TIN validation given that Form SSA-7028 is no longer available.

INTERIM PROCEDURES

To obtain validation of the payee's SSN from the SSA for purposes of responding to a second B notice, each individual payee should now contact the local SSA office and request a Social Security Number Printout. The Social Security Number Printout will validate the SSN of the individual and will serve as acceptable validation of the individual's TIN for purposes of the requirements of section 3406. An individual may request one free copy of the Social Security Number Printout, which will verify the SSN assigned to that individual. The individual should provide a copy of the Social Security Number Printout to the payor who sent the second B notice. A payor who receives a copy of the Social Security Number Printout validating the SSN of a payee will not be required to commence backup withholding, and may stop backup withholding, on reportable payments made to that payee.

A payor sending a second B notice to an individual payee should inform the payee of this change in procedure. The following language is acceptable:

Note that the Instructions for Incorrect Social Security Numbers have changed and the SSA no longer uses Form SSA-7028. You must request a Social Security Number Printout from SSA rather than Form SSA-

7028. You must send a copy of the Social Security Number Printout directly to us, along with a copy of this notice.

These interim procedures may be used until additional forthcoming guidance, including a revision of Rev. Proc. 93-37, is published.

DRAFTING INFORMATION

The principal author of this Announcement is Nancy Rose of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this announcement, contact Ms. Rose at (202) 622-4940 (not a toll-free call).

Appendix E
IRPAC Comments on Cost Basis Proposed Regulations (February 26, 2010 and March 3, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

February 26, 2010

Mr. Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (REG-101896-09)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Mr. Schaffer:

The Information Reporting Program Advisory Committee ("IRPAC")[1] is pleased to submit for your consideration comments on the proposed cost basis regulations.[2] Our comments are divided into four parts as follows:

I. Impact on Foreign Account Tax Reporting

II. Subchapter S Corporation Reporting Changes

III. Equity-Based Compensation

IV. Remaining Cost Basis Comments

Enclosed herein are Parts I and II of our comments. IRPAC expects to provide Parts III and IV early next week.

IRPAC appreciates this opportunity to comment on the proposed cost basis regulations and remains committed to assisting the IRS in finalizing these rules. If you have any questions, we would be happy to set up a conference call.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
Chairman
2010 IRPAC

LMC:az
Enclosures

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

[2] REG-101896-09, 74 FR 67009 (Dec. 17, 2009).

I. Impact on Foreign Account Tax Reporting

This Part I of our comments addresses the impact of the proposed regulations on foreign account tax information reporting with a focus on the amendment to the definition of "broker" in Treas. Reg. § 1.6045-1(a)(1), and the elimination of the "eyeball" test in Treas. Reg. §1.6045-1(c) as it affects the current treatment of per se foreign corporations as exempt from Form 1099-B reporting.

A. Proposed Change to Definition of Broker for Non-U.S. Payor QIs

1. Background

Code section 6045 and the regulations thereunder require a "broker" to file returns of information on Form 1099-B to report the sales of securities, commodities, regulated futures contracts and forward contracts that it effects for customers. The current regulations reflect that the benefits of Form 1099-B reporting by foreign persons on foreign accounts are outweighed by the costs and burdens that would be imposed on those payors, the vast majority of whose clients are foreign persons that are not subject to U.S. taxation on gains and therefore are exempted from Form 1099-B reporting. Accordingly, the definition of "broker" was crafted to carve out foreign persons acting outside the United States who are not under U.S. control. The current regulations accomplish this by excluding from the definition of "broker" non-U.S. payors and middlemen that do not effect sales inside the United States.

The current qualified intermediary ("QI") program also recognizes the practical limitations of Form 1099-B reporting by QIs outside U.S. jurisdiction. The QI Agreement therefore provides that QIs that are not U.S. payors are subject to Form 1099-B reporting only with respect to assets that produce, or could produce, U.S. source income and even then the QIs may pass up that responsibility to their U.S. custodians. No Form 1099-B reporting is generally required for non-U.S. source assets.

When the Obama Administration initially proposed treating QIs as U.S. payors in its 2010 Greenbook in order to force all QIs to do Form 1099 reporting, the practical challenges of such a requirement were discussed with the Treasury and members of Congress. In apparent recognition that non-U.S. payor QIs are unable to perform Form 1099 reporting, and that forcing non-U.S. payor QIs to do so would cause QIs to withdraw from the QI Agreements with the IRS, the proposal for non-U.S. payor QIs to do full Form 1099-B reporting was not included in the Foreign Account Compliance Tax Act ("FATCA").[1] Instead, FATCA – which the administration has now endorsed –provides that QIs must provide the IRS with limited information regarding U.S. persons, or alternatively elect to do full Form 1099 reporting.

[1] *See* section 1.6049-5(c)(5).

Against this backdrop, the IRS released the proposed cost basis regulations. The Preamble to those suggests the regulations as currently drafted would amend the definition of broker in Treas. Reg. § 1.6045-1(a) to, in effect, treat any QI as a U.S. payor for Form 1099-B purposes (including both gross proceeds and cost basis reporting). This would be the case even if the QI is not a U.S. payor or middleman. IRPAC is aware that drafting the cost basis regulations was a lengthy, difficult process that began long before FATCA was released and the Preamble may reflect the Administration's initial proposal that would subject non-U.S. payor QIs to Form 1099-B reporting. Nevertheless, the Preamble statement now stands in stark contrast to the information reporting proposals contained in FATCA.

2. Impact of Proposed Cost Basis Regulations

If the cost basis regulations become effective as proposed and QI Agreements are modified to reflect the amended definition of "broker", QIs that are currently non-U.S. payors will become U.S. payors or middlemen with all of the requisite Form 1099-B reporting obligations (which include reporting the basis and holding period of securities sold and, if necessary, backup withholding) with respect to the non-U.S. source assets of the QIs' U.S. non-exempt recipient customers. Under the broker definition in the Preamble to the proposed regulations, non-U.S. payor QIs would therefore be required to incur economic costs of developing Form 1099-B systems and processes, with no U.S. support, for what is likely to be a relatively small number of U.S. non-exempt recipient customers. These costs could be extensive particularly given that most QIs have little to no knowledge of the current Form 1099 reporting requirements, much less the cost basis reporting rules. IRPAC questions whether the information that the government will obtain on Forms 1099-B from non-U.S. payor QIs (for likely a relatively small population of U.S. non-exempt recipients) justifies the costs that QIs worldwide would have to incur to be compliant with the proposed section 6045 regulations. This is particularly the case given that, as explained in more detail below, if FATCA becomes law, the government will obtain from QIs, under a separate reporting obligation, relevant account information related to the QIs' U.S. accounts.

3. Correlation with Proposed "Foreign Account Tax Compliance" Legislation

If enacted, the proposed FATCA provisions will generally require foreign financial institutions ("FFIs"), including non-U.S. payor QIs, to enter into agreements with the IRS to identify and report to the IRS information regarding the institutions' U.S. accounts or otherwise be subject to 30% withholding on withholdable payments.[2] FFIs would be able to satisfy their reporting obligation

[2] Witholdable payments generally include payments of U.S. source fixed or determinable annual or periodic income, including dividends and interest, and any proceeds from the sale or other disposition of any property of a type which can produce U.S. source dividends or interest.

by providing the following information with respect to U.S. accounts: name, address and TIN of U.S. account holders (or, for accounts of U.S.-owned foreign entities, the name, address and TIN of each substantial U.S. owner of such entity), the account number, the account balance or value, and the gross receipts and gross withdrawals or payments from the account. Alternatively, the FFI can elect to do Form 1099 reporting.

As noted above, the FATCA provisions are an outgrowth of the Greenbook proposals made by the Obama Administration in May, 2009. One of the proposals which would have treated all QIs as U.S. payors, and required them to report on Forms 1099 all reportable payments received by the QI on behalf of U.S. account holders including Forms 1099-B for gross proceeds. The QI community's response to this proposal was that requiring non-U.S. payor QIs to comply with Form 1099 reporting requirements was not realistic given the economic and administrative costs of compliance weighed against the low number of U.S. accounts held by QIs. There was a concern that, if the proposal was enacted, some QIs would be effectively forced to withdraw from the U.S. market rather than comply with the new rules. When the FATCA proposals were released in October 2009, it was apparent that the drafters had heeded the QIs' concerns. The Administration proposal to treat all QIs as U.S. payors had been eliminated from the revised FATCA provisions; and the more simplified reporting was included as an option for U.S. accounts.

4. IRPAC Recommendation

IRPAC recommends that, in light of the Congressional decision to eliminate from FATCA provisions that would treat all QIs as U.S. payors required to file Forms 1099-B, the IRS strongly consider exempting non-U.S. payor QIs from the cost basis reporting requirements except to the extent otherwise currently applicable.

B. Elimination of "Eyeball" Test for Foreign Corporations

1. Current Law

Foreign corporations are generally not subject to U.S. income tax on gains from the sale of personal property, like stock and securities.[3] Under the current section 6045 regulations, a broker may rely on two main exceptions for not reporting sales of customers that are foreign corporations on Forms 1099-B. First, a broker is not required to provide Forms 1099-B to exempt recipients, which include corporations, whether U.S. or foreign. Second, a broker is not required to provide a Form 1099-B with respect to sales effected either inside or outside the U.S. to an "exempt foreign person", which generally is a person that is either documented (with a Form W-8) or presumed to be a non-U.S. person.[4]

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[3] IRC § 865(a)(2).
[4] *See* Treas. Reg. §1.6045-1(g)(1)(i).

Under the "exempt recipient" rules, a broker can currently treat a person as a corporation by relying on the indicator set forth in Treas. Reg. §1.6049-4(c)(1)(ii)(A)(*1*), which allows the broker to "eyeball" the name of the person to determine the person's corporate status. A broker may treat a payee as a corporation if (1) the payee's name contains an unambiguous expression of corporate status that it is a corporation[5] or (2) its name indicates that it is an entity listed as a per se corporation under the section 7701 regulations. The second part of the test allows a broker to identify a payee by "eyeballing" its name as that of a foreign entity that, under U.S. entity classification rules, can only be treated as a corporation for U.S. tax purposes. Examples include a British public limited company (PLC), a German Aktiengesellschaft (AG) or a French société anonyme (SA). Under the "exempt foreign person" rules, on the other hand, a broker is required to either obtain documentation (generally a Form W-8) or apply presumption rules to determine the customer is a foreign corporation, and therefore exempt from Form 1099-B reporting. Those presumption rules, in turn, lead back to the eyeball test described above.[6] Thus, whether one thinks of a PLC, AG or SA as an exempt recipient or as an exempt foreign person, the current rules properly provide that a broker need not issue a Form 1099-B to such an account holder, whether the broker obtains documentation or not.

2. Proposed Elimination of "Eyeball" Test

The broad exception to reporting sales of securities by corporations will soon change as new section 6045(g)(4) requires brokers to report sales by customers that are S corporations of covered securities acquired on or after January 1, 2012. To effect this statutory change, the proposed regulations exclude S corporations from the list of exempt recipients, and also eliminates the "eyeball" test in Treas. Reg. §1.6049-4(c)(1)(ii)(A)[7]. The proposed regulations eliminate both parts of the "eyeball" test, including the part related to foreign corporations even though a foreign corporation cannot be an S corporation.[8] While foreign corporations will still be considered exempt recipients, a broker will no longer be able to identify a foreign corporation as such solely by its name. Instead, it appears that a broker would be obligated to collect documentation from the foreign corporation establishing foreign status.

[5] For example, a payee's name contains an unambiguous expression of corporate status if the name contains the terms Incorporated, Inc., Corporation, or Corp. In almost all cases, brokers apply this test to identify only U.S. payee corporations.
[6] Treas. Reg. § 1.6045-1(g) cross-references to the presumption rules in 1.6049-5(d), which in turn cross-references Treas. Reg. § 1.1441-1(b)(3)(i)-(ix). Treas. Reg. § 1.1441-1(b)(3)(iii)(A) provides rules for when a payment made to an exempt recipient is presumed to be made to a foreign person. To determine whether a person is an exempt recipient for this purpose, the rules of Treas. Reg. § 1.6049-4(c)(1)(ii), including the eyeball test, apply.
[7] We note that the Preamble to the proposed regulations suggests an intent solely to eliminate reliance on the "eyeball" test in Treas. Reg. §1.6049-4(c)(1)(ii)(A)**(1) (emphasis added)** while the regulations prohibit the reliance of any indicator of corporate status in Treas. Reg.§1.6049-4(c)(1)(ii)(A), including reliance on corporate resolutions, or Forms W-8 or W-9. We do not believe this broad prohibition was intended and instead that there is a drafting error in the proposed regulations that should be clarified.
[8] An S corporation may only be a domestic corporation. *See* IRC §1361(b).

3. Eliminating the Eyeball Test for Per Se Foreign Corporations Does Not Address the IRS's Concerns

The Preamble to the proposed regulations indicates that the "eyeball" test was eliminated because, in the IRS's view, brokers cannot infer from a customer's name whether the customer is taxed as an S corporation or C corporation. This assertion is incorrect with respect to per se foreign corporations, which can be readily identified by name and cannot be S corporations. The proposed rule would require brokers to collect documentation from every customer that is a per se foreign corporation to prove the customer is foreign or backup withhold on sales of those customers and then report them on Form 1099-B. The current regulations are correct to provide a straightforward way to prevent the issuance of needless Forms 1099-B to per se foreign corporations IRPAC believes that the result of the proposed regulations we describe above was not an intended result of the elimination of the "eyeball" test.

4. Recommendation

IRPAC will provide a separate letter (Part II) that will recommend for several reasons, that the "eyeball" test not be eliminated. However, if the recommendation is not accepted, IRPAC alternatively recommends that the regulation be clarified to reflect that reliance on the "eyeball" test is not prohibited for determining who is an exempt foreign person. Brokers should be able to rely on the "eyeball" test to determine if a payee is a per se foreign corporation exempt from Form 1099-B reporting, particularly given that a per se foreign corporation cannot qualify as an S corporation.

II. Subchapter S Corporation Reporting Changes

This Part II of our comments addresses the impact of the proposed regulations on Form 1099-B reporting to S corporations.

A. Elimination of the "eyeball" Test

Background: Under current regulations, Forms 1099-B are not required to be issued for sales effected for any corporation, including a Subchapter S corporation. New IRC §6045(g)(4), effective for the sale of securities acquired after December 31, 2011, requires a S corporation to be treated as a partnership. As a result, brokers will be required to identify corporations that have made Subchapter S elections so that they can comply with the Form 1099-B reporting requirements. However, brokers have no other reason to distinguish S corporations from all other corporations and their systems are not designed to do so. Further, brokers typically rely on the "eyeball" test to treat corporations as "exempt recipients" under current law and therefore do not typically require corporations to provide Forms W-9.

The "eyeball" test in Treas. Reg. §1.6049-4(c)(1)(ii)(A)(1), is currently utilized to identify corporations exempt from Form 1099-B reporting. Under this regulation, absent actual knowledge otherwise, a payee may be treated as an "exempt recipient" if (i) the name of the payee contains an unambiguous expression of corporate status (such as Incorporated, Inc., Corporation, Corp., or P.C., but not Company or Co.), (ii) the name contains the term *insurance company*, *indemnity company*, *reinsurance company*, or *assurance company*, or (iii) the payee is a foreign entity listed as a per se corporation under Treas. Reg. §301.7701-2(b)(8)(i).

Proposed Changes: To implement the new requirement under IRC §6045(g)(4) that brokers report sales of covered securities acquired on or after January 1, 2012 by customers that are S corporations, the proposed regulations have excluded S corporations from the list of recipients exempt from Form 1099-B reporting. Whether a corporation is a Subchapter C corporation or an S corporation cannot be determined based on the name of the entity. As a result, the proposed regulations would completely curtail the ability of financial institutions to rely on the "eyeball" test to determine whether the customer is a corporation exempt from reporting. This strategy is problematic and overreaching for several reasons:

- The proposed cost basis regulations would disallow the use of the "eyeball" test to identify exempt corporations even if the payee is a corporation that would otherwise never qualify as an S corporation, such as corporations that are publicly traded or foreign corporations listed as a per se corporation in Treas. Reg. §301.7701-2(b)(8)(i).

- The proposed cost basis regulations would also effectively disallow the use of the "eyeball" test in determining whether an account holder could be treated as an exempt corporation for Forms 1099-DIV and 1099-INT purposes. Payors typically apply the exempt recipient rules by account, and not by income type within an account. As a result, transactions not intended to be covered by the cost basis reporting (dividends and interest) will likely be reported.

- S corporations are estimated to represent less than 1% of all corporate accounts held by financial entities that would be required to report cost basis information. Elimination of the "eyeball" test for identifying exempt corporate entities would require payors to solicit all corporations currently treated as exempt under the "eyeball" test to determine whether they are S corporations, and in the end such effort would uncover very few reportable accounts. Such a broad solicitation requirement would be a very expensive endeavor for financial institutions for little benefit.

- If Forms W-9 become required for identifying exempt corporations under Treas. Reg. §1.6049-4(c)(1)(ii)(A)(3), it would have to be revised to include a check box for the S corporation status.

- Remember that 99% of the accounts are still exempt. Many corporations have never been asked to complete a Form W-9 and many will fail to do so on this new request. Since the "eyeball" test has been repealed, there will be no other way to avoid backup withholding. It is possible that millions of corporations will experience inappropriate 28% backup withholding (that cannot be refunded) on their gross proceeds for failing to react timely.

Recommendations:

- Consideration should be given to allowing the existing Treas. Reg. §1.6049-4(c)(1)(ii)(A)(1) "eyeball" test to continue to be applied as is, granting exemption unless the payer has actual knowledge of the S corporation status since the population of these entities with investment accounts is so small. This approach should be considered at least for existing accounts with a coupling of a new rule for prospective new accounts opened after 2011 to be screened for S corporation status.

- At a minimum, use of the "eyeball" test under Treas. Reg. §1.6049-4(c)(1)(ii)(A)(1) should be allowed to continue for entities that could never qualify as an S corporation, such as foreign “per se” corporations under Treas. Reg. §301.7701-2(b)(8)(i)[9] and large public entities. This will cut back on the wave of inappropriate backup

[9] See IRPAC’s cost basis comment letter, Part I (Impact on Foreign Tax Account Reporting) for a more detailed discussion of the elimination of the eyeball test as it affects foreign “per se” corporations.

withholding that could occur should the proposed regulations be finalized as written.

- IRPAC reiterates the recommendation made in its report dated October 28, 2009, that the IRS consider expanding its TIN Matching program to allowing payers to use the program for identifying S corporation status, particularly since Form W-9 request mailings are burdensome and the Form W-9 will not likely be amended by the regulations' effective date. Such an alternative will improve the integrity of tax reporting of S corporations where their identity is in question.

- IRPAC further recommends that the IRS reconsider its initial denial to allow S corporation reporting to apply only to accounts opened after December 31, 2011, when S corporations can be appropriately identified going forward and after a new Form W-9 has been developed that helps to identify S corporations.

III. Equity-Based Compensation

A. Introduction

The preamble to the proposed regulations states that the regulations do not address rules regarding reporting for options, compensatory options, or other equity-based compensation arrangements because options are only subject to the requirements of section 6045(g) and (h) if granted or acquired on or after January 1, 2013. It states that these rules are expected to be addressed in future guidance.

This comment letter is intended to address reporting considerations arising in the context of compensatory options, or other equity-based compensation arrangements. In our letter dated August 5, 2009, IRPAC covered suggestions regarding the reporting of the equity options in general, and we direct your attention to those comments on the broader considerations.

In anticipation of such future guidance, we have provided an overview of the current Code provisions and authority that applies to such equity-based compensation to give a full appreciation of the complexities involved and the danger in adding an additional level of reporting to the existing structure. Specifically, as described below, each type of equity based compensation is subject to its own taxation provisions, which include the treatment on sale of such employer stock and associated comprehensive reporting rules, which include Forms 1099-R, W-2, 1099-MISC for non-employees, and proposed Forms 3921 and 3922.

B. Types of Compensation

1. Employer Stock Distributed From a Qualified Plan

Most types of tax-favored retirement plans can hold and distribute employer stock, including 401(k) plans, employee stock ownership plans (ESOPs), stock bonus plans, and profit sharing plans. The tax treatment of employer stock depends on whether the payment is a lump sum and whether the employee elects to defer taxation of the net unrealized appreciation (in the case of a lump sum). In general, an employee's receipt of entire account balance in a single year due to separation from service, age 59½, death or disability is considered a lump sum distribution. Net unrealized appreciation ("NUA") is the excess of the fair market value (“FMV”) of the stock on the date it is distributed over the stock's cost or other basis in the hands of the plan's trustee.[10]

- Lump-Sum. When a lump-sum distribution includes employer stock, the FMV of the stock, less NUA (if elected by the employee), is included in the employee's gross income. Code § 402(e)(4), (j). The NUA is not taxable until the employee disposes of the stock. The remainder of the FMV of the stock distributed is included in the employee's gross income to the extent it exceeds his after-tax

[10] Various methods and rules may be used to determine the cost basis to the plan trustee. For example, distributions that include appreciated and depreciated stock, such unrealized appreciation and depreciation must be combined to determine NUA. Treas. Reg. § 1.402(a)-1(b)(2).

contributions. The gain recognized on the sale of the stock, to the extent it does not exceed the amount of the NUA as of the date of distribution, is taxable as long-term capital gain, regardless of the holding period of the stock. If the gain exceeds the NUA, the character of the gain (either long term or short term) depends on the holding period of the employee, which begins with the date of distribution. Treas. Reg. § 1.402(a)-1(b).

- Other Distributions. If the distribution is not a lump sum, only the NUA attributable to the employee's after-tax contributions (along with any accumulated deductible employee contributions) is deferred. Any gain realized on a sale of the stock is long-term or short-term capital gain depending upon the holding period of the stock, which begins with the date of distribution.

  For purposes of determining gain on the sale of stock, the employee's basis is determined as follows: (1) if the NUA is less than the excess of the value of all cash and property received in the distribution over the employee's basis in the plan, the stock basis is the FMV of the stock at date of distribution less the NUA at date of distribution (i.e., employee's basis is the same as the plan's basis – and all shares have the same basis); and (2) if the NUA is greater than the excess of the value of the cash and other property received in the distribution over the employee's basis in the plan, the stock basis is the employee's basis in the plan less the amount of cash and FMV of property (other than employer stock) received in the distribution.

A distribution of employer stock is reported on Form 1099-R. Box 1 reports the gross distribution, box 2a reports the taxable portion of the distribution (which does not include the NUA, as described above), and box 6 reports the NUA. Additional rules apply if the employer stock is rolled over to an IRA or another eligible employer plan.

2. Statutory Stock Options

Statutory stock options include incentive stock options under Code section 422 (ISO), and employee stock purchase plans under Code section 423 (ESPP). With an ISO, an employer grants an employee an option to buy employer stock with an exercise price no less than the FMV at the grant date and a term of 10 years or less. To receive favorable tax treatment, the shares must be held for one year after the exercise date and two years after the grant date. With an ESPP, employees defer after-tax pay into an account that accumulates over a period of time, typically three months to two years, at the end of which employees may use the money to purchase employer stock. Usually, the stock is offered at a discount from either the price at the end of the period or at the beginning of the period, or both. The discount typically is up to 15%.

- ESPP. The tax treatment of the sale of ESPP stock depends on whether the ESPP option was granted at a discount and whether the holding period was satisfied, which is the later of the 1-year period after the exercise date, or the 2-year period after the option was granted. Code § 423; Treas. Reg. § 1.423-2.

    - No Discount – Qualified Disposition. If the employee meets the holding period, the employee recognizes capital gain or loss equal to the sales proceeds less the exercise price of the ESPP option (long term or short term based on the holding period from the date of exercise).

    - No Discount – Disqualified Disposition. If the employee does not meet the holding period, the gain (sales proceeds less exercise price) is ordinary income up to the amount that the stock's FMV at exercise exceeded the exercise price; any excess is capital gain. If the sale results in a loss, it is a capital loss and there is no ordinary income (long term or short term based on the holding period from the date of exercise).

    - Discounted Option – Qualified Disposition. If, at the time the option was granted, the exercise price was less than 100% (but not less than 85%) of the FMV of the share, and the employee disposes of the share after meeting the holding period, or dies while owning the share, the employee must include in income as compensation, the lesser of (1) the FMV of the shares on the date the option was granted minus the exercise price, or (2) the amount realized on the disposition or death minus the exercise price. For this purpose, if the exercise price was not fixed or determinable at the time the option was granted, the option price is figured as if the option had been exercised at the time it was granted. Any excess gain is capital gain. If the employee has a loss from the sale, it is capital loss, and no compensation income is reported.

    - Discounted Option – Disqualified Disposition. If, at the time the option was granted, the exercise price was less than 100% (but not less than 85%) of the FMV of the share, and the employee disposes of the share before meeting the holding period, the employee recognizes ordinary income equal to the stock's FMV at the time of exercise over the exercise price. In addition, the capital gain or loss is determined by taking the sales proceeds less the basis (i.e., the basis equals the exercise price of the stock plus the ordinary income recognized).

- ISO. Upon sale of the stock, the tax treatment depends on whether the employee has satisfied the special holding period requirements. If the employee does not dispose of the shares received within two years after the date the option was granted or within one year after the transfer of the shares to him, any gain realized will be long-term capital gain, with the basis determined as the amount the employee paid for the stock. Otherwise, the sale results in a disqualifying disposition and the amount equal to the lesser of (1) the FMV of the shares on the date of exercise minus the exercise price, or (2) the amount realized on the disposition minus the exercise price, will be taxed as ordinary income in the taxable year of the disposition. The excess, if any, of the amount realized upon disposition over the FMV at the time of exercise of the option will be treated as long-term capital gain if the shares have been held for more than one year following the exercise of the option. Code § 421; IRS Pub. 525, p. 12.

- Reporting of ESPP and ISOs. Recent IRS regulations mandate IRS reporting on Forms 3921 and 3922 of information intended to enable an employee to calculate their tax obligation in the event of a sale of the ESPP/ISO stock. Treas. Reg. § 1.6039-1. As noted above, the tax treatment and reporting of the sale depends on a number of factors, including if the special holding period was met and whether the ESPP was discounted, which cannot be determined at the time of transfer to a broker. A portion of the gain may be treated as capital gain that is reported on Schedule D (Form 1040) while another portion may be treated as ordinary income that is reported as wages on Form W-2 or Form 1040, line 7. For example, an employer is required to report in box 1 of Form W-2 (a) the discount portion of stock acquired by the exercise of an ESPP option upon disposition of the stock, and (b) the spread (between the exercise price and the FMV of the stock at the time of exercise) upon a disqualifying disposition of stock acquired by the exercise of an ISO or an ESPP option. IRS Pub. 15-B, p. 11. Moreover, cashless exercises of ISOs/ESPPs are currently exempt from 1099-B reporting where such amounts are reported on Form W-2 by the employer and otherwise meet the requirements of Revenue Procedure 2002-50.

3. Nonqualified Stock Options (NQSO)

Employer grants employee an option to buy employer stock, with no tax code restrictions on the option as long as it is based on the fair market value of the stock. Upon exercise of a NQSO, the employee generally recognizes W-2 wages measured by the excess of the then FMV of the shares over the exercise price.[11] Upon sale of the stock, the employee will recognize a capital gain or loss (long term if the stock is held over a year), based on the difference between the sales

[11] If the employee receives an option that has a readily determinable FMV at the time of grant, the option is taxable on grant and no income is recognized on the exercise of the option. Also, on disposition of the stock, the holding period for determining capital gain or loss begins as of the date the employee acquired the option.

price and the employee's basis. For this purpose, the employee's basis equals the amount paid for the shares (e.g., exercise price) plus any ordinary income recognized as a result of the exercise of the option. Treas. Reg. § 1.83-7.

On exercise of a NQSO, the excess of the FMV of the shares over the exercise price is reported in boxes 1, 3 and 5 of Form W-2. This amount is also reported separately in box 12, code "V." IRS Pub. 15-B, p. 11. This amount, along with the exercise price, makes up the employee's basis for a later sale of the stock, which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).

Moreover, cashless exercises of certain NQSOs are currently exempt from 1099-B reporting where such amounts are reported on Form W-2 by the employer and otherwise meet the requirements of Revenue Procedure 2002-50.

4. Stock Appreciation Rights (SARs)

Employer grants employee a right to receive, without payment, the excess of the FMV of the employer stock on the exercise date over the base price. This award may be paid in employer stock, cash, or a combination of cash and employer stock. Upon exercise of the SAR, the employee has W-2 wages in the amount of the award. If the award is paid only in stock, the basis in the stock is the amount reported on Form W-2 as wages. (If the employee receives cash and stock, the amount reported as W-2 wages is allocated pro-rata between the cash and the FMV of the stock). On sale of the stock, the employee receives long term or short term capital gain/loss treatment (based on the holding period of the stock), generally equal to the sale proceeds less the stock basis (as determined above).

Upon exercise, the employer reports in boxes 1, 3 and 5 the FMV of the award. This amount becomes the employee's basis in the stock (if the award is paid entirely in stock) for a later sale of the stock, which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).

5. Restricted Stock

Employer issues company stock to the employee (or in his or her name), subject to forfeiture if vesting conditions are not satisfied. These shares are nontransferable prior to the vesting date. For example, an employee must work for 3 years from the grant date of the award. The employee will recognize W-2 wages when the stock is no longer subject to a substantial risk of forfeiture (unless the employee makes a § 83(b) election) equal to the FMV of the stock on such vesting date less any amount paid by the employee in exchange for the stock. On sale of the stock, the employee receives either long term or short term capital gains/losses, based on the holding period of the stock, generally equal to the sale proceeds less the stock basis. For this purpose, the employee's basis equals the amount paid for the shares plus any ordinary income recognized when the stock was received or became vested.

In general, upon vesting, the employer reports in boxes 1, 3 and 5 the FMV of the stock less any amount paid by the employee for such stock.[12] This income, along with any amount paid for the stock, makes up the employee's basis for a later sale of the stock, which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).

6. Restricted Stock Units (RSUs)

Employer grants employee a right to receive employer shares (or their value in cash) in the future if vesting conditions are met. If the RSUs are settled in employer stock, the employee will recognize W-2 wages when the stock award is no longer subject to a substantial risk of forfeiture equal to the FMV of the stock on such vesting date less any amount paid by the employee in exchange for the stock. On sale of the stock, the employee receives either long term or short term capital gains/losses, based on the holding period of the stock, generally equal to the sale proceeds less the stock basis. For this purpose, the employee's basis equals the amount paid for the shares plus any ordinary income recognized when the stock was received or became vested.

If the RSUs are settled in employer stock, upon vesting, the employer reports in boxes 1, 3 and 5 of Form W-2 the FMV of the stock less any amount paid by the employee for such stock. This income, along with any amount paid for the stock makes up the employee's basis on a later sale of the stock, which will generate either long term or short term capital gain/loss treatment.

C. Conclusion

As illustrated above, these arrangements are different from transactions that are the primary focus of Code section 6045(g) and the new Form 1099-B basis reporting rules because they are not subject to the basis recovery and capital gain rules under Code sections 1012 and 1222. In addition, where options and their exercises are involved in the compensation context, reporting of any related taxable income is already handled as reportable wages in the payroll processing, including W-2 reporting where required (or on Form 1099-MISC if involving an independent contractor or a member of the Board). Therefore, we respectfully offer our continued assistance as the Service works through these very difficult issues, and have the following general recommendations.

[12] Different rules apply if the employee elects to take the value of restricted property at the time of transfer (minus any amount the employee paid for the award) into income for the year of the transfer by making a Code section 83(b) election. In that case, the general rules above do not apply, and any later appreciation is not W-2 wages. Moreover, the basis in the property is the amount paid for the award plus the amount included in income under the election.

D. Recommendations

IRPAC recommends the following with respect to developing rules for tracking and reporting cost basis for equity-based compensation:

1. The Service should carefully consider the long-standing basis and reporting positions of equity-based compensation before requiring any separate reporting of exercises of compensation-based options.

2. The Service should carefully consider the long-standing basis and reporting positions of equity-based compensation before requiring any basis disclosures on Form 1099-B pursuant to Code section 6045(g) or subjecting such compensation to the transfer statement requirement of Code section 6045A. A key concern is to avoid unnecessary duplicative and potentially inaccurate or misleading basis reporting due to the unique nature of equity-based compensation. Therefore, to the extent that any basis information is needed to be reported on Form 1099-B (or a transfer statement provided), any such reporting should be reviewed in light of the existing reporting under Forms W-2, 1099-R, 1099-MISC, 3921 and 3922 in order to avoid duplication and misleading data. Also, any change should be coordinated and reflected in the various IRS guidance available for participants to calculate income resulting from equity-based compensation, including Publications 15-B, 525, and 575.

3. The current exception for Form 1099-B reporting for certain cashless exercises pursuant to Revenue Procedure 2002-50 be retained and interpreted to exempt such compensation from any new cost-basis reporting or transfer statements under Code sections 6045(g) and 6045A.

4. Any guidance should be made effective prospectively, with a delayed effective date with good faith transition relief. Brokers, plan sponsors and third-party administrators will need ample time to update plan documents (including award letters, prospectus, plan documents, participant statements) and coordinate systems, which historically have been not integrated and not designed to support additional data.

IV. Remaining Cost Basis Comments

This Part IV contains IRPAC's remaining comments on the proposed cost basis regulations, and is divided into subsections as indicated in the following summary outline. Please note that the order in which issues are presented is not indicative of priority or importance and that numbering is provided solely for ease of navigation and reference.

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IV. Remaining Cost Basis Comments

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A. Need for final rules quickly and penalty relief

A.1. **There is an urgent need to issue final rules quickly, and consideration should still be given to extending the effective date for equities to 2012, and providing penalty relief**.

The effective date for the new rules is January, 2011, and the likelihood that affected parties will be able to implement them in time is slim. Even if the regulations are finalized in the next few months, the necessary guidance will not have been made available in time to guide required system development and provide time for testing of system changes. In addition, there will not be sufficient time to educate financial institution staff and their customers. As pointed out below, there are many implementation details that remain ambiguous or that are impossible to implement in the remaining time frame.
Recommendations*:* IRPAC recommends that serious consideration be given to delaying the implementation of some of these provisions to 2012, particularly as they apply to transfer statements; and to deferring enforcement of the gift and inheritance provisions to 2013. Provisions should also be made for penalty relief in the first few years of the new regime, in recognition of the following: (1) Complex systems development will take several years, and in some cases will require changes to the underlying trade processing systems; (2) The recent economic downturn has affected the financial services industry particularly hard so that funds needed for systems development and training are limited or not available; (3) Developmental issues are fairly complex, even on matters as simple as determining who owns needed data, and it will take time to work through the interrelated processes; and (4) Financial service providers are traditionally not tax return preparers.

B. Impact of existing inconsistent treatment of certain transactions and available elections on cost basis tracking

B.1. **Greater simplicity and uniformity is needed with respect to the application of available cost basis adjustments and taxpayer election options.**

Greater uniformity and simplicity is needed in the application of cost basis adjustments and in the allowance of taxpayer elections and changes for the basis reporting process to function effectively on automated reporting systems. Although many financial institutions are well-positioned to become the main repository for standard cost basis information, many are unable to track the numerous variety of events, adjustments and taxpayer-level elections that could impact the basis of a security. For reporting purposes, therefore, many of the currently possible adjustments and available elections need to be streamlined, and taxpayers should be made aware that in some circumstances the cost basis per their records may differ from information provided on Form 1099-B.

The proposed cost basis regulations do not address current inconsistencies in the treatment of certain transactions for gross proceeds reporting purposes, and this inconsistency will impact the accuracy and consistency of cost basis tracking, in particular when a security is transferred between brokers that apply different treatments.

IV. Remaining Cost Basis Comments

The Preamble suggests that such issues are beyond the scope of the regulations. However, there is a lack of clear processing uniformity under current rules for many categories of transactions, such as those listed below, and it should be noted that the tax reporting issues arising from this lack of clarity will be made worse when carried through the new cost basis reporting requirements.

- Allocation of a return of capital

- Treatment of stock redemption transactions under IRC §302

- Application of the currency conversion requirements under IRC §988

- Other substantive rules throughout the tax code that require or permit basis adjustments in situations that arise infrequently

Existing lack of uniformity with respect to cost basis adjustments will create processing gaps between institutions that will result in uneven taxpayer treatment. In addition, gaps can always be abused by a well planned security transfer that targets the advantages. Failure to address cost basis uncertainties under existing law in conjunction with development of the new cost basis regulations, substantially diminishes the likelihood of successful industry- wide production of accurate cost basis information..

We recommended in our March 2, 2009, letter that since it is impractical to require that brokers be responsible for tracking all possible events, adjustment options and taxpayer-level elections that impact basis, financial institutions should be treated as passive repositories of basis information, rather than guarantors as to its accuracy. We noted that the Service should not strive for perfect reconciliation between the information reported on Forms 1099-B and the information on the taxpayers' tax returns. Instead, the final regulations should provide for more uniform calculations and standardized reporting methods. In many areas, the proposed regulations fail to take this recommended course of action, leaving the taxpayer free to elect an extensive variety of cost basis methods, and to make changes (sometimes retroactively) without the imposition of reasonable limitations to take into account the capabilities of financial systems.

Unless available adjustment options are streamlined, financial institutions will not be able to accomplish numerous, bulky manual adjustments whenever requested by a taxpayer. This is particularly the case if limitations are not placed on the time-frame during which financial institutions are required to process adjustments and election change requests.

Recommendations: Attention needs to be given to providing guidance on certain transactions that lack consistent and simple treatment under existing law, and to putting limitations on elections as described in more detail below at B.2 through B.X. In addition, taxpayers should be advised that cost basis information as reported on Form 1099-B may not take into account all possible adjustments and available elections and may differ from their reporting on Form 1040 Schedule D (Capital Gains and

Losses). Instructions to the Schedule D and related Service publications should clearly explain the limitations of broker-furnished basis information and the need to make certain adjustments when preparing tax returns. An alert is also needed to advise taxpayers and tax return preparers of the types of circumstances likely to result in differences. In addition, a standard method of addressing differences between taxpayer/customer maintained basis information and such information as reported on Forms 1099-B needs to be developed.

B.2. Limitations are needed on a taxpayer's ability to elect or change basis calculation methods for reporting purposes.

IRPAC is concerned that customers may be given the flexibility to make or change cost basis elections in a manner that does not take into account what is workable for reporting institutions. In addition, as discussed above, there are numerous events that are extrinsic to a taxpayer’s account with a financial institution that could impact a taxpayer’s basis in their securities, and that are beyond the tracking means available to brokers using automated systems. This was a point IRPAC emphasized in its March 2, 2009 letter to the Service on cost basis needs.

A critical point in the proposed regulations is that they do not permit a broker to turn down a taxpayer's election request. In addition, a request to change an election can be made over a period of time. This will require brokers to spend significant capital to develop systems to handle every available method of basis calculation (including those that are rarely used) and to retain a significant level of detail in order to enable them to reverse and recalculate basis when a customer elects to change methods at any time. This may make compliance cost prohibitive for some small and midsize brokers even if they choose to completely outsource the process. See Prop. Reg. §1.6045-(d)(6), (7) and §1.1012-1(e).

To require a financial institution to spend the capital to support all available basis methods, including those rarely used by a very small number of customers, will increase the costs of investing for everyone in the market. If support of all methods is required by the regulations some brokers may simply not be able to absorb or pass on these costs to their customers, causing them to close their doors.

It should be noted for comparison that taxpayers are allowed to choose between various levels of tax preparation software, on-line tax return preparation services and highly skilled, but more expensive, tax accountants to prepare their tax returns. Taxpayers are able to select tax preparation services that meet their level of need and are willing to pay more for a more sophisticated service if they need it. We do not require that every preparer and every tax preparation system offer the most advanced and complex level of service for every return, nor do we require taxpayers to pay for a level of tax return preparation services that they do not need. The same thought process needs to be applied to cost basis methods as a level of service provided by brokers.

Recommendations: As pointed out in IRPAC comments made in our letters dated March 2, 2009, and again in June 23, 2009, there should be an allowance for business restrictions to be contractually imposed by a broker that would set the terms of account support; and where the customer wants the flexibility of a different method, the customer can shop the marketplace for an institution that will provide the desired level of service. In turn, because the support of a multiplicity of options is very costly to develop, brokers who are able to offer more variety of supported cost basis methods should be able to charge higher fees. As long as the methods supported by the broker are clearly communicated to the customer at the onset, brokers should be permitted to limit options by agreement.

B.3. <u>Long-term holding period needs to be a standardized for uniform system application</u>.

Currently IRC §1222 requires securities to be held "for more than 1 year" to be considered “long-term”, and similarly, Service instructions in Publication 550 use the same term. There are many different ways under appropriate accounting standards that an annualized term is tracked: a standardized 365 days, a standardized 360 days, actual calendar days (which poses problems regarding yearend crossovers), etc. Where different firms use different methods, the inconsistencies can be manipulated, and basis reporting will be inconsistent. The regulations need to specify the long-term holding period to standardize the holding period for reporting purposes.

Recommendations: IRPAC recommends a new provision be added to the reporting regulations under IRC §6045(g) that applies only for reporting purposes on Form 1099-B. The provision should establish a uniform protocol under which the long-term holding period would be considered met after a specified number of days (365 or 360). Reporting regulations under IRC §6045(g) should make this application clear with examples. IRPAC also recommends that examples be added to the regulations that clarify the existing requirements that holding periods begin on the day after "trade date" and include the day the property was disposed of (trade date of the sale).

B.4. <u>Tax reporting requirements for distributions in the context of tax-free reorganizations and IRC §302 transactions need to be clarified, including stock tender offers, particularly where distributions can be either a dividend, partial liquidation or a return of capital.</u>

Most broker systems will still treat proceeds from tender offers as sales of the tendered securities. Treatment this way allows for an offsetting elimination of the presented tax lots. Security systems were not designed to support the payment as a taxable dividend. Even where amounts are recharacterized as taxable dividends, the security is nonetheless eliminated from the account. Guidance is needed as to whether a Form 1099-B will still need to be filed when a redemption is reclassified as a dividend, and, if so, what information it should contain. In addition, it is possible for a distribution generally characterized as a sale by the issuer, to be required to be recharacterized as a dividend by a particular shareholder on their own tax return due because they own shares of the same security with multiple financial institutions. It is therefore not always possible for any one financial institution to accurately determine whether the IRC §302 requirements for sale treatment have been satisfied for each customer. Obtaining holder certifications supporting sale treatment similar to those now required for Form 1042-S reporting purposes is not workable if applied to every shareholder in the domestic market who tenders shares. This is particularly true for shares in large publicly traded companies.

Consideration also needs to be given to whether and how Form 1099-B reporting will be required, how communication between the customer/taxpayer and the broker will be made, how transfer statement information will be relayed and how uniform standards will be addressed for these transactions. It will be critical to standardize the process for everyday mechanical issues relating to the computation of stock basis and of what is reported on any related sales for these transactions.

***Recommendations**:* The information necessary to determine the tax character of certain tax-free reorganizations and redemptions at the individual customer level is generally outside the scope of the information that the financial institution has available. Brokers should be allowed to report on Forms 1099-B based upon their books and records, which, for tendered shares, will be as a sale of the tendered shares. Where the taxpayer receives a taxable cash distribution from an otherwise tax free reorganization, the broker should be permitted to report based upon the issuer notice that accompanies the payment. Sometimes the cash would be reported on a Form 1099-B as a disposition of a portion of the underlying shares; sometimes it would be reported as a taxable dividend, or where there is no E&P, as a return of capital. Taxpayers will need to be provided with guidance to address the difference between the character of a transaction as reported on the Form 1099-B and he position they may take (due to information specific to their individual circumstances) on their own tax returns.

B.5. Tax reporting for other transactions that require basis adjustments also need to be clarified.

Consideration also needs to be given to whether and how Form 1099-B reporting will be required, how communication between the customer/taxpayer and the broker will be made, how transfer statement information will be relayed and how uniform standards will be addressed for a number of other transaction types, such as the following, just to name a few:

- Accounting for IRC §1043 basis rollovers in conflict-of-interest sales;

- Handling the mark-to-market method of accounting for securities under IRC §1256;

- Managing and reporting constructive sales when the position remains on the broker's books, particularly regarding when the shares are later transferred to another broker;

- When making basis adjustments for straddles: if a position becomes straddled and it is not determined to be a constructive sale, the loss deferral rules only allow the loss on the closing transaction to be recognized to the extent it would exceed the unrealized gain on the retained portion of the position. Unused losses are carried forward to the next year. Currently, if the straddle involves an option the application is not required until the Service writes option rules and should be addressed at that time. However, where the straddle is because of a short sale the adjustments may need to be made as early as 2011. The Service needs to clarify whether basis adjustments of this nature belong on the taxpayer's Schedule D or on the Form 1099-B.

- Extraordinary dividend-related loss adjustments for a security that paid a qualified dividend where the loss must be treated as long-term to the extent of any extraordinary dividend that equals or exceeds 10% (5% in the case of preferred stock) of the taxpayer's adjusted basis in the stock. Extraordinary dividends are rare, but not as rare as in prior years so efforts will need to be made to identify them and support the basis adjustments. Accomplishing any of this would require tracking of all extraordinary dividends (perhaps prorated) against short-term positions, which is not currently part of any broker's process.

- S Corporations will require special treatment and unique tracking on the receipt of extraordinary dividends. If any corporation receives any extraordinary dividend with respect to any share of stock and the corporation has not held the stock for more than 2 years before the dividend announcement date, IRC §1059(a)(1) requires that the basis in the stock be reduced (but not below zero) by the non-taxed portion of the extraordinary dividends. If the non-taxed portion of the dividends exceeds the basis, any excess is to be treated as gain from the sale or exchange of the stock for the taxable year in which the extraordinary dividend is received. For this purpose, there is an alternative provision for determining whether a dividend is extraordinary which allows the taxpayer to elect to substitute for its adjusted basis the FMV of the share of stock on the day before the ex-dividend date, provided that the FMV can be established to the satisfaction of the Service. See IRC §1059(c)(4). This election can prevent a basis reduction for stock that has appreciated significantly since it was acquired. At issue is how this election is to be handled for basis reporting. A corporation's receipt of extraordinary preferred dividends qualified under IRC §1059(e)(3) will also have other unique tax treatments that could affect basis. Special programs will be necessary to meet SCorp reporting needs that are not presently a part of any broker's basis program. Guidance is needed on how these issues will be handled for reporting purposes.

- Short sale basis adjustments where the taxpayer closes the short sale by the 45th day after the date of the short sale (1 year or less in the case of an extraordinary dividend so these will also need to be tracked—see above) and cannot deduct the payment in lieu of the dividend that is made to the lender. Instead, the taxpayer must increase the basis of the stock used to close the short sale by that amount. This will mean tracking the substitute payment details so that adjustments can be made.

- Basis adjustments to covered shares are required where the fair market value of the stock right is 15% or more of the fair market value of the old stock**.** The proposed regulations will allow brokers to elect to take into consideration option premiums in determining cost basis and gross proceeds of securities bought and sold pursuant to the exercise of an option granted or acquired before 2013 as long as the treatment is consistent with the broker's books. Where the taxpayer elects

– On the other hand, if the taxpayer exercises or sells stock rights that were not taxable on distribution, and if at the time of the rights distribution, the stock rights had a fair market value of 15% or more of the fair market value of the old stock, the taxpayer must divide the adjusted basis of the old stock between the old stock and the stock rights, using a ratio of the fair market value of each to the total fair market value of both at the time of distribution. In most cases the old stock and the rights will be considered uncovered and the adjustment not required. However, technically, where the old stock is acquired in 2011 or 2012 with a stock right that has a value of 15% or more, then brokers may be required to determine the correct cost basis of the shares since they are "covered" and the fact that some basis will be allocated to the "uncovered" rights will not preclude making the adjustment to the "covered" shares. This is a rare event but the adjustment will be required if it should occur. These matters should be left to the account holder's tax accountant and not be part of a broker's cost basis tracking.

Recommendations: Reporting protocols should be issued under IRC §6045(g) that work for large-scale processing and that follow present legal trade protocols. Tracking of certain complex basis adjustments are beyond the capacities of many systems, and adjustments in these complex cases should be handled by the taxpayer on Schedule D. As a result, as discussed at B.1. above, taxpayers will also need guidance regarding how to reconcile differences between Form 1099-B reporting and the position taken on an individual tax return.

B.6. Need to standardize what is a "tax lot," considering limit and market order processing.

During recent discussions with Counsel’s cost basis team, we discussed the importance of tying tax lot information to broker books and records in the context of market and limit orders. An SEC no-action letter dated March 3, 2005, provides the terms for when a single combined trade confirmation can be used to confirm the execution of multiple trades. If those terms are met, and a single confirmation is issued, the regulations should allow one tax lot to cover all securities reported in that single confirmation. Pursuant to the no-action letter, the broker-dealer can average the execution prices of each individual execution that filled a market order or crossing limit order and report the average price per share on the confirmation as the unit price pursuant to the letter, with a notation that confirms that the price is an average price, if all the following conditions are met:

a. The confirmation will note that details regarding the actual prices are available to the customer upon request.

b. The confirmation will identify each of the capacities in which the broker-dealer actually acted in executing the order, e.g., “principal,” “agent,” “agent and agent for another," "principal and agent," "or "principal, agent, and agent for another," as applicable.

c. The confirmation will note that details regarding the capacity (including, when acting as agent for another, the name or names of the person or persons from whom the security was purchased, or to whom it was sold) with regard to each execution are available to the customer upon request.

d. The commission, markup, markdown, service fee, and any other remuneration to the broker-dealer associated with each individual execution will not be detailed separately, but will be stated in a single amount for the transaction as a whole. The confirmation will note that further details regarding the remuneration are available to the customer upon request.

e. The confirmation will include all other information required by Rule 10b-10.

f. Each individual execution will be reported separately under the applicable trade reporting rules.

g. Each broker-dealer that issues average price and/or multiple capacity confirmations will create and maintain records required under Exchange Act Rules 17a-3 and 17a-4, in a manner that reflects the processing and confirmation of orders as described above and the details of each underlying execution.

Recommendations: IRPAC believes that "tax lot" should be defined looking to what is considered to be a transaction to be confirmed for securities laws purposes under Rule 10b-10. This approach will tie the broker's records in an auditable way to the Form 1099-B reporting sales of the lots involved and to the cost basis on purchases that anchor the tax lot. Rule 10b-10 requires trade confirmations to include the date and time of the transaction (or the fact that the time of the transaction will be furnished upon written request to such customer) and the identity, price, and number of shares or units (or principal amount) of such security purchased or sold by such customer.

B.7. Need to standardize foreign currency treatment.

Proposed regulations extend the present foreign currency applications for handling reportable gross proceeds with all the concerns that they present to basis reporting for U.S. tax reporting purposes. If a purchase or sale of a reportable security is completed in a foreign currency, clarity is still needed on the rate of conversion to U.S. currency to meet the cost basis reporting requirements. At issue is when to convert: trade date or settlement date, and how. This will become a very critical concern, particularly if non-U.S. payer QIs become subject to the Form 1099-B reporting requirements with respect to non-U.S. assets.

Currently, for reporting gross proceeds on Form 1099-B, if the proceeds of a sale are paid in foreign currency, brokers are required to convert the reportable amount into U.S. dollars on the payment date at the spot rate or by following a reasonable spot rate convention. It is important to note that the broker is not technically required to actually convert the currency to U.S. dollars. The term is used loosely to designate how to derive the dollar amounts entered into the Form 1099-B. The broker may also use a month-end spot rate or monthly average spot rate convention if the broker uses the convention consistently. Most reporting brokers choose to use the payment date (settlement date) spot rate rather than a convention. Where backup withholding applies, 28% of proceeds is taken on the payment date, and then converted to U.S. dollars.

But, these rules were designed to address the immediacy of the reporting of gross proceeds from the sale and may not really cover the right substantive treatment for cost basis purposes, which needs to consider the possible impact that the currency value fluctuations may have over the holding period of the security and any receipt of income in that currency over that time that may require a basis adjustment. The security will always be denominated in some other currency and there will always be some currency value fluctuation (gain or loss) in the security independent of the movement of the pricing of the security itself. Currently, Reg. §1.6045-1(d)(6)(ii) attempts to tackle some of these concerns and requires that in lieu of the amount reportable under the conversion rule above, the amount subject to gross proceeds reporting can be an integrated amount computed under the elections in Reg. §1.988-5(a),(b) or (c) but only if the taxpayer effects through a broker a sale or exchange of nonfunctional currency (as defined in §1.988-1(c)) and hedges all or a part of such sale as provided in §1.988-5(a), (b) or (c) with the same broker; and the taxpayer complies with the requirements of §1.988-5(a), (b) or (c) ***and so notifies the broker prior to the end of the calendar year*** in which the sale occurs. Under these special §988 elections, the gain or loss on the currency movement over the settlement period (the forward contract embedded in the sale contract) can be capitalized to reduce or increase the gross proceeds or basis of the security as applicable.

It is important to note that since one approved method for Form 1099-B reporting now is to convert the reportable amount into U.S. dollars on the payment date (settlement date) at the spot rate, for those that use this method, correct reporting has occurred even without broker notice of the §988 election.

Application of this same rule for basis purposes will greatly simplify the cost basis reporting requirements, but note that we need to contemplate how and whether it is necessary that the taxpayer notify the broker of the §988 election. Moreover, we need to know how this process will impact any future adjustments to the security based on issuer actions, the wash sale rules or other substantive tax considerations. For example, where the security has the same CUSIP number, but where a §988 election applies to one tax lot and not to another, will the securities remain "identical"? Prop. Reg. §1.6045-1(d)(8) merely requires the sale and hedge be through the same broker, that the currency be a non-functional currency as to the customer, and that the customer convey to the broker that they comply with Reg. §1.988-5(a), (b) or (c) prior to the end of the calendar year in which the sale occurs. The next question to ask is what will happen if that security is then transferred? Will the hedge relationship carry over? Does it need to be specified to the receiving broker in some component of the transfer statement?

Although the proposed regulations are silent on these and many other points, if a customer fails to make a §988 election, the basis probably should be initially established using the currency spot price on the trade date and, separately, the taxpayer would have a reportable and taxable currency gain or loss on the forward contract. With the §988 election, that currency gain or loss is merely adjusted into the basis amount and in theory, the basis becomes the spot price on settlement date (the better answer for everyone since it is the date the cash actually changes hands).

Recommendations: Note that if the current Form 1099-B currency rule is applied by default, every transaction will be treated as if the §988 election has been made (even without an election in place) since the foreign currency is converted to dollars on settlement date, ignoring the currency movement over the settlement period. This may also mean that all other basis adjustments must be made using the spot rate on that adjustments payment date. This is a viable solution for uniform processing and one that IRPAC recommends.

B.8. <u>Option and debt obligation rules are needed quickly</u>.

The proposed regulations do not address rules regarding reporting for options, including equity-based compensation options, or reporting of adjusted basis for bonds, notes and other debt securities. The preamble to the proposed regulations cited the longer period of time before these items become subject to the new laws, and stated that these items will be addressed in future guidance.

Many financial institutions have not yet developed any resource for basis tracking of options. It will take time to build these processes from scratch. Although option reporting is deferred to 2013, instructions are needed as soon as possible so systems can be developed to appropriately track these items. It is important to remember that until recently options did not have universal identification numbers (like CUSIPs); so a new uniform street tracking process will need to be developed. Where tax matters are part of this new legal endeavor, it would be best to have them outlined quickly so they can be considered in the new process. Most brokers' retail systems, apart from those involving commodities and futures, are not set up to handle mark-to-market accounting required under IRC §1256 for clients. Terms, time frames, and abilities will need to be considered by many before final rules that are workable can be established.

It will also be important to remember that debt instrument basis adjustments are fairly sophisticated and not all elections may be readily supportable across the board. For the present, many brokers do not provide basis information on debt instruments apart from initial cost. Those that do provide basis information reach out to third parties to calculate and the cost is pricey. Some brokers may not have the bandwidth or funds to track this information.

Those financial institutions that do have basis tracking for debt obligations, may not always handle the more complex debt instruments like mortgage-backed securities (REMICs) or account for returns of principal and other required adjustments. For many, handling the details of debt instruments will also require a rewrite of their processes that will take time.

Recommendations: It is important that the reporting requirements for these investments be identified as soon as possible to allow for development time. What are current timelines and how can IRPAC help?

B.9. <u>The application of any inheritance and gift provisions once finalized should have a deferred effective date until 2013, and regulations for these provisions should be given lowest priority</u>.

Under the proposed regulations, gifted and inherited securities that were covered securities in the account of the donor or decedent remain covered securities when transferred to another account and must be accompanied by a transfer statement. When covered securities are transferred from a decedent, the transfer statement must indicate that the securities are inherited. The transfer statement must also report the date of death as the acquisition date and must report adjusted basis in accordance with the instructions and valuations provided by an authorized representative of the estate. The proposed regulations require that the selling broker take these basis adjustments into account in reporting adjusted basis upon the subsequent sale or other disposition of these securities. See Prop. Reg. §1.6045A-1(b)(3).

For inherited securities, the proposed regulations allow the applicable person effecting the transfer to rely on the authorized estate representative to provide the instructions and valuations necessary to report correct basis for any transferred securities. If the applicable person effecting the transfer does not receive instructions and valuations from the authorized estate representative, the applicable person must request this information from the authorized estate representative before preparing the transfer statement. If this information is not provided before the transfer statement is prepared, then the transfer statement must indicate that the transfer consists of an inherited security but must report the security as a noncovered security. If this information is provided after the transfer statement is sent, the applicable person effecting the transfer must send a corrected transfer statement. See Prop. Reg. §1.6045A-1(b)(3).

When covered securities are transferred to a different owner as a gift, the proposed regulations require the statement to indicate that the transfer consists of gifted securities and to state the adjusted basis of the securities in the hands of the donor and the donor's original acquisition date of the securities. T he transfer statement must also report the date of the gift (if known when furnishing the statement) and the fair market value of the gift on that date (if known or readily ascertainable). Upon the subsequent sale or other disposition of these securities, the selling broker must apply the relevant basis rules for gifts when reporting adjusted basis. See Prop. Reg. §1.6045A-1(b)(4).

The above rules are complex and will impact a broad range of persons not likely to be accustomed to providing cost basis information. As a result, before the transfer statement rules related to inheritance and gift provisions are finalized, all parties including estate planning specialists and fiduciaries in the business of handling estates impacted by the provisions should have ample opportunity to comment. IRPAC believes that many planners and fiduciaries are unlikely to have devoted much attention to the proposed cost basis regulations, under the general belief that they apply only to custody banks and brokers. In addition, for reasons discussed below, the proposed regulations addressing inheritance and gifts will take more time to fully understand, and related applications will take more time to develop and deploy.

- Presently, there is no means for handling the relay of transfer information from a private party to a broker, particularly if the individual does not have an account or other relationship with the broker. It will take time for an industry standard to be established to handle this process and certainly, it cannot be accomplished by 2011 when the rules are intended to become effective.

- There will be a significant need to educate the public on these rules perhaps for several years before they can be fully effective. Many times the stock certificate is brought in with a stock power by the beneficiary or the donee for sale by a broker. The individual often has no history of the security except that it was a gift or inheritance. The history of the stock transferred by gift or inheritance is frequently lost and research is needed to develop basis information. The proposed regulations place the burden on the authorized estate representative or the donee and for the most part, consider the needs of very large estates or large gifts. Day-to-day practice is very different with by far the majority of transfer events involving small estates and small gifts.

- Even with large estates, in practice, the estate representative usually relies on a close relationship with a broker to determine values on publicly traded securities. Those executors may have a hard time understanding why establishing cost basis information is now their burden. Moreover, many seniors still retain shares in their safety deposit boxes and give certificates away in small lots of a few hundred shares or less. On death or in a gift transfer, particularly in smaller estates, the shares can come in broken lots (less than the rounded number of shares (100) traded on an exchange) making it difficult and expensive to sell. There is also not always a formal, authorized estate representative to handle the smaller matters. Placing the burden of establishing cost basis on the party presenting the shares to the broker, will greatly encumber the present process for handling these matters and will also increase the cost of settling estates and processing gifted securities.

- Some brokers assist clients with basis information, but others, such as online brokers, may not be able to offer this service. Placing the burden on the executor or donor seems appropriate, but the proposed rules will cause a market shift in business since more will bring their business to brokers who can handle the details. In addition, it is likely that the public will have a hard time accepting this responsibility because they are accustomed to relying on other third parties to develop the information for them, or the shares being brought in for trade are so few that the cost of obtaining basis information may outweigh the value of selling the shares..

- Most brokers were led to believe that gifted and inherited shares would be excluded from the basis reporting rules and were surprised to see their inclusion.

For the rules to work, they will need to be better refined, explained in a manner understandable to the average person, and widely circulated beyond the financial service community. Consideration should be given to separately publishing the gift and inheritance rules apart from the other cost basis rules, targeting the estate planning and return preparer community for comment.

Recommendations: The other transfer statement requirements of Prop. Reg. §1.6045A-1 should be a prime focus for finalization, deferring the finalization of the rules related to inheritance and gift transfers in Prop. Reg. §1.6045A-l(b)(3) and (4) until the many industries impacted have time to consider the provisions and to submit appropriate comments. Even after rules are agreed upon, industry standards for private parties to provide the required transfer statements will be slow to develop since they impact such a wide audience, many of whom are still unaware that the temporary regulations may affect them. It may therefore take several years to put programs together to handle these rules, and once the regulations are finalized, a deferred effective date of 2013 is more reasonable looking at the tasks ahead.

C. Revision of Form 1099-B

C.1. <u>Eliminate reporting of number and class of shares in an acquisition of control or substantial change in capital structure</u>.

The 2010 version of Form 1099-B, requires reporting in Box 5 of the number of shares exchanged by the recipient in an acquisition of control or substantial change in capital structure; and also requires the class of stock to be identified in Box 6. This information is not required to be disclosed on the draft 2011 version of Form-B. IRPAC was asked to comment on the elimination of this data from the draft Form 1099-B. IRPAC believes that the data eliminated would be superfluous once gain/loss and basis data is required to be reported for equities and should not be added back. Financial institution will be required to adjust gain/loss in any Form 1099-B resulting from an acquisition of control or substantial change in capital and also adjust the basis and holding period of shares accordingly.

Recommendations: The transactions covered in these boxes 5 and 6 on the 2010 Form 1099-B are rare and better left off the final 2011 Form 1099-B. Reporting of that information would duplicate adjustments already required to be made in the 2011 reportable gain/loss, causing confusion to both taxpayers and return preparers. IRPAC was asked to comment on whether Boxes 5 and 6 could be merged if retained. If determined that such information needs to be reported, then merger into one box of the information now reported in the two boxes would reduce the clutter on the form.

C.2. Address differences in adjusting for commissions and transfer taxes.

There is a confusing lack of reporting parity in adjusting for commissions and transfer taxes. The adjustment to reportable gross proceeds is an election on the face of the Form 1099-B that fails to address transfer taxes, while the adjustment to reportable cost basis is mandatory, addresses transfer taxes, but fails on the face of the form to make clear that the basis adjustment has been made.

Under the proposed regulations, the adjusted basis of a purchased security is increased by commissions *and transfer taxes*. See Prop. Reg. §1.6045-(d)(6). The current and proposed section 6045 regulations do not allow a similar adjustment to sales proceeds for transfer taxes for Form 1099-B reporting purposes, although most financial institutions include the transfer tax offsets if reported on the security confirmation. See Reg. §1.6045-1(d)(5). The draft Form 1099-B uses the traditional language for the election in Box 2: ***Gross proceeds less commissions and option premiums***. The proposed regulations should make these adjustments mandatory for commissions and transfer taxes as to both gross proceeds and cost or other basis and no longer optional to avoid confusion to taxpayers. The proposed regulations require cost basis amounts to be reported including these adjustments, removing the election to adjust for commissions from gross proceeds would bring the two reporting requirements into parity and be less confusing. The Form 1099-B needs a bold alert that amounts reported in Boxes 2 and 3 include adjustments for commissions and transfer taxes to alert taxpayers and return preparers not to duplicate the adjustment.

Recommendations: IRPAC recommends that the final regulations require reporting of gross proceeds and cost basis in the same manner, adjusted by commissions and transfer taxes, since most brokers already do so. IRPAC recommends that the Service state explicitly on the form that the adjustments for commissions and transfer taxes have already been made to reported items in Boxes 2 and 3. If it is still necessary to indicate a gross proceeds election in Box 2 regarding adjustments for commissions, add transfer taxes to the election language. In either case, Reg. §1.6045-1(d)(5) needs to be amended to include transfer taxes as allowable offsets.

C.3. Address option premium reporting concerns.

The following issues also need to be addressed with respect to the reporting of option premiums:

- In the industry, option premiums are not always used to adjust gross proceeds, but commission adjustments are always adjusted. Election collectively applies to both adjustments, putting reporters in a precarious position.

- Brokers that adjust gross proceeds for option premiums on covered calls, for example, may not also adjust basis for any related option premiums involved in purchase transactions. Option premium adjustments to gross proceeds need to be separately treated from adjustments to basis.

- The Form 1099-B does not make clear on its face whenever the basis has been adjusted by any option premiums.

Adjusting for option premiums should be handled separately from commissions and at least until options become reportable in 2013, the election to adjust for option premiums as it relates to reporting proceeds should be independent from any election regarding reporting basis. Under the proposed regulations, the broker may elect to adjust cost basis and proceeds by any option premiums if securities were acquired or sold pursuant to the exercise of an option granted or acquired before 2013.

Recommendations: The Form 1099-B should indicate whether or not the broker has elected to adjust cost basis and proceeds by any option premiums. This is necessary to avoid a duplicative adjustment on the part of a taxpayer who may not be aware that the adjustment is already included in the reported numbers. For sales proceeds reported in Box 2, combining this election with one for commissions is inappropriate as every broker nets commissions and only a few offset by option premiums. Combining the elections puts a broker in a difficult position. See comments above. The option premium election for gross proceeds reported in Box 2 needs to be separated from the option premium election to adjust cost or other basis reported in Box 3. Our suggestion is to drop the "commissions" language altogether from the election in the proceeds box (see recommendations above), converting the election to one of option premiums only, and separately place an election for option premium adjustments to cost or other basis in Box 3, as many brokers presently adjust for premiums on covered calls, but few adjust the premiums for purchases.

C.4. <u>Clarify whether reporting for disallowed wash sale losses is independent of the gain/loss reportable in Box 7.</u>

The first consideration is what is the best mechanism for handling disallowed losses from a reporting standpoint, and the second consideration is how such losses should be made clear on the Form 1099-B to encourage taxpayer compliance. Proposed regulations would require a broker to report to customers engaging in wash sales the amount of any disallowed loss as well as make basis adjustments to the acquired shares that triggered the wash sale application. See Prop. Reg. §1.6045-(d)(6).

In review of the draft 2010 Form 1099-B and in the ensuing IRPAC discussions, it became apparent to all that a gap existed between industry handling of wash sale disallowed losses and the reporting contemplated on the draft Form 1099-B. The draft would require separately tracking and reporting disallowed losses, and reporting the gain/loss from the wash sale without adjustment for the disallowed loss. This is not how most in the industry currently handle data from wash sales and will require major programming changes on the part of most.

Systems will need to be redesigned so that adjustments are not made to the reported gain or loss from the wash sale trade, but instead the system separately captures and tracks the disallowed loss amount, and stores it independently after making the basis adjustment to the acquired shares that triggered the wash sale rules. This way of processing is very disparate from the way many systems now work. Our survey of several financial institutions disclosed that most adjust the wash sale gain/loss and the basis of the acquired shares that triggered the wash sale by the amount of the wash sale disallowed loss. At which point, the disallowed loss is removed from immediate access with retention available only for audit trail purposes. Very few brokers separately track the disallowed loss once the gain/loss from the wash sale has been recorded and the basis of acquired shares adjusted. However, when asked, many brokers saw the value of separately tracking and reporting the disallowed loss and making the basis adjustment, but not adjusting the reported wash sale gain /loss even though it would mean major system changes on their part when we explained that it would allow taxpayer to make their own adjustments across accounts in their Schedule D (Form 1040).

The changes that this way of reporting wash sales will require to a broker's process should not be minimized and there is not enough time left in this year to properly effect these changes. If this way of reporting is required, wash sales rules should therefore be pushed out to 2012 before being made effective to allow time for this reprogramming. Many systems track wash sales by adjusting the actual basis of the securities in question as the Service regulations require. To mandate a change that requires that wash sale losses be addressed separately, together with a requirement not to adjust the wash sale gain or loss but to carry the loss adjustment to the acquired shares' basis to be considered in yet a future Form 1099-B report is highly problematic for many, and time is needed to figure out a way to handle this within each institution's separate process.

In addition, consideration will need to be given as to how this separate data will now be relayed in a transfer statement when the adjusted securities are later transferred. If time to reprogram is not allowed, the data may make the Form 1099-B (albeit not properly since programming and testing time is cut short), but probably will not be available for transfer statements since that programming must first be worked through the DTCC process[13] (discussed further below) before individual brokers can begin to internally program for the industry accepted changes. Critical cost basis data for transfers stand the risk of being lost. A new category of transfer information (the disallowed wash sale loss) will have to be established and programming developed to handle the transfer.

A rushed job to accomplish all of these new programming changes, combined with what will be a real learning curve for taxpayers who are used to seeing wash sales reported to them differently and filing returns based on that pattern, will result in mismatched and possibly inconsistent Forms 1099-B and incorrect taxpayers' returns. As a trade association has recently pointed out, if the intent of the proposed regulations is that the brokers are to maintain two sets of basis information, gross and net, then it is back to the

[13] There currently exist uniform broker-to-broker information transfer standards (ACATs) and a system to accomplish relay of transfer statement information. The system is Cost Basis Reporting System (CBRS) maintained by DTCC.

drawing board from a systems perspective to track wash sales for Form 1099-B reporting purposes and basis transferring purposes.

Recommendations: If the disallowed loss is to be handled separately as described above, then there will need to be an extension of the effective date of these rules to allow time for development of a new way to handle the data. If this is the case, IRPAC suggests an extension at least to 2012.

From the perspective of the draft form, if the disallowed loss is to be reported separately and not used to adjust reported gain or loss in Box 7, the most important change needed is to clearly explain on the face of the Form 1099-B that the Box 5 disallowed loss adjustment has not been used to adjust amounts reported in Box 7, Reported gain or loss, and will need to be reported on the payee's tax return.

If the adjustment is to be included in Box 7, a checkbox should be added to indicate that wash sale losses are included in the amount reported. We note that many times instructions to the Forms 1099 are not read by return preparers, so burying the remarks in the instructions may not preclude a double inclusion of the loss adjustment or even a failure to include the loss adjustment when the preparer wrongly assumes what is included in the numbers reported.

C.5. Form 1099-B reporting treatment and transfer statement sharing of the carryover of the holding period in a wash sale needs to be clarified.

Consideration needs to be given as to how holding period adjustments due to wash sales should be noted on Form 1099-B and included in transfer statements. The holding period for substantially identical stock or securities acquired in a wash sale includes the period the old stock or securities were held. The holding period carries over with the disallowed loss basis adjustment. If disallowed loss amounts are considered separately from reported gains and losses, should the holding period character adjustment be indicated on the Form 1099-B when the retained securities are later sold? If so, how will such information be handled in a transfer statement?

Recommendations: Currently, most brokers carry over the holding period adjustment to the tax lots supporting the acquired shares when the basis adjustment is made. The easier way of handling this reporting need would be to place a checkbox in Box 8, Type of gain or loss, to mark if wash sale holding adjustments were included in the determination. Similarly, the transfer statement should carry such an earmark where basis information being transfer has been adjusted by a wash sale.

D. Transfer Statements - Applicable Persons

Clear definition of the term "applicable person" is critical as only an “applicable person” is required to provide a transfer statement on the transfer of a security; and transfer statement information facilitates the accurate tracking of cost basis. In any case that a transfer statement is not passed on for a covered security because the transferor does not consider itself to be an "applicable person", that security will drop out of the reporting process because the receiving brokers will be permitted to treat such security as an uncovered security . Any confusion as to the categories of persons that are or are not "applicable persons" could therefore cause serious gaps in the overall cost basis reporting regime. In addition, certain "applicable persons" are permitted under the proposed regulations to provide more limited information than others on transfer statements; and these rules may also present gaps in the transfer of complete basis information. The following comments address some of these gaps, and also address inequities in the penalty relief available to brokers who in good faith attempt to fill such gaps.

D.1. Clarify meaning of a "person that acts solely as a clearing house for the transfer".

The proposed regulations expressly exempt from the definition of "applicable person" "any person that acts solely as a clearing house for the transfer." There is uncertainty surrounding the meaning of this term. Arguably, brokers currently exempt from Form 1099-B reporting who operate in DVP[14] and multiple broker arrangements (see section E below) are operating solely as "a clearing house for the transfer" as to trades processed in those arrangements since they do not purchase for or post the securities or proceeds to the specific customer's (beneficial owner's) account. However, there has been a great deal of confusion over the years regarding the meaning of the term "clearing organization" as the phrase exists currently in Reg. §1.6045-1(b) Example 2 (vii). Initially this exception was intended to cover such entities as the Depository Trust Company, the clearing organization for the NYSE. In practice, the exception has been extended to cover many other organizations and has lost its clear meaning. Therefore, use of this term in the cost basis regulation needs to be clarified.

Use of the term "clearing" in and of itself has many different meanings in the securities business. For example, a "clearing broker" processes trades, posts the securities or proceeds to the specific customer's account and produces the statements and confirmations for an introducing broker. Clearing brokers do Form 1099-B reporting under their federal EIN even though they do not have the primary relationship with the customer.

Further, the group of persons who should provide transfer statements is larger than the group that is required to report gross proceeds on Form 1099-B. So it surprises us to find this language used in an exception to the definition of "applicable person." It is far better to use the actual business classifications in defining this exception rather than a blanket statement that exempts "any person that acts solely as a clearing house for the transfer."

[14] Cash on delivery transactions (also known in the industry as the RVP/DVP exception): In the case of a sale of securities through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale. If, however, the broker's customer is another broker (second-party broker) that is an exempt recipient, then only the second-party broker is required to report the sale." [Reg. §1.6045-1(c)(3)(iv)] Like the multiple broker rule, this rule is actually a deferral rule that requires the final broker in the chain who is responsible for paying the holder or crediting the gross proceeds on the sale to that holder's account to report the sale on Form 1099-B.

It is also important to note that many taxpayers still hold purchased securities in their safety deposit box. When customers hold securities in their own name, their stock certificates are registered with transfer agents on purchase. When ownership changes on the transfer agent's books, the transfer agent does determine whether the security has been purchased or gifted or inherited. When the securities are then later transferred to a broker for sale or custody, the transfer agent shifts the ownership into the street name of the broker. Under the older rules, these functions would not require Form 1099-B reporting. Nonetheless, many times it is this agent that has the only basis information available and when the security is transferred to the broker, a transfer statement should be required. These are still covered securities. See Prop. Reg. §1.6045A-1(a)(3). If the transfer agent considers itself exempt as "a person that acts solely as a clearing house for the transfer" when they are registering the ownership of shares, then there would be no further relay of basis information to the broker when later transferred to a broker in street name to facilitate an owner's sale.

Recommendations: Further clarification is needed as to what it means to "act solely as a clearing house for the transfer." In IRPAC's view, it is far better to use the actual business classifications with examples in defining an exception rather than a blanket statement that exempts "any person that acts solely as a clearing house for the transfer." Once IRPAC understands what is intended to be covered by this phrase, we can help you formulate a better definition and define examples.

D.2. Gaps in transfer statement information create a need for brokers to be able to rely on third party information without risk of penalty.

Under the proposed regulations, an "applicable person" is a broker within the meaning of Reg. §1.6045-1(a)(1) and is defined to include any person that acts as a custodian of securities in the ordinary course of a trade or business, any issuer of securities, and any agent of these persons. However, the proposed regulations carve out limitations for issuers, transfer agents, professional custodians, and other certain applicable persons who may not effect sales so that they are not required to adjust for issuer actions or calculate basis using averaging methods. For these applicable persons ("Limited Applicable Persons"), transfer statement duties are limited to a duty to receive the statement when receiving custody of transferred securities and then to retransmit the information on the statement when transferring custody of those securities to a broker (or, if no statement is received, to furnish a statement that the securities are noncovered securities). The proposed regulations regarding transfer statements do not impose a duty on those that do not effect sales to update basis in response to adjustments announced by issuers under IRC §6045B or to compute basis by average cost under IRC §1012, as these computations apply only to basis reporting at the time of sale under IRC §6045 and, thus, apply only to brokers effecting sales. We understand that adjusting basis and computing basis using average cost may be new territory for certain Limited Applicable Persons, but note that they are often agents of the issuer who would be closer to issuer-related basis adjustments than many brokers.

In addition, basis information for securities issued in the owner's name (safe-kept securities) is tracked by the taxpayer, their accountant, or even their investment advisor, but these parties are not "applicable persons" and are not required to provide transfer statements to brokers under these new rules even though brokers derive much of their basis information from these sources today.

Many investment advisors have historical basis information for securities they recommend and track gains and losses in these securities for their clients as part of their services. If an investment advisor moves an account from one broker to another broker, the investment advisor should be allowed to supply the basis information to the new broker where available and the new broker should be allowed to rely on it even if the old broker transfers basis data to the new broker in the course of the transfer.

The proposed regulations deem that a broker that takes into account information received from a customer or third party other than information reflected on a transfer statement or issuer statement is considered to have relied upon such information in good faith in accordance with existing rules found in Reg. §301.6724-1(c)(6) **as long as** the broker neither knows nor has reason to know that the information is incorrect.

While the above described provisions are very positive, they may not be broad enough to cover existing practices. As discussed above, the proposed definition of “applicable person” and the carve outs in place for “Limited Applicable Persons” will often leave a gap in basis information received by a broker. In practice, a broker may need to rely on third party information to construct the most accurate basis possible for a transferred security, and should not be penalized for such good faith attempts to clean up basis. The “knowledge or reason to know” standard in the proposed regulations would require brokers to perform due diligence with respect to third party information, if they are to rely on it in lieu of transfer statement information, even if they know the transfer statement information is incorrect. This approach reflects a bias in favor of the accuracy of transfer statements over third party information that may not be appropriate in practice, especially in light of gaps in the transfer statement process discussed above.

Recommendations: Consideration should be given to requiring all “applicable persons to provide information that they do have with respect to events requiring basis adjustment. In addition, in cases where a broker cleans up basis information in good faith that they know was wrong when provided to them, the regulations should allow the broker to use the best information available without risk of application of penalties.

E. <u>Transfer statements – DVP and multiple broker rule</u>

E.1. <u>Application of DVP exemption rules.</u>

IV. Remaining Cost Basis Comments

The DVP[15] rules under current regulations result in only the clearing broker or custodian reporting the sale to an otherwise reportable owner on Form 1099-B. In a DVP account, the DVP broker (i.e., the executing broker) never holds custody, but instead follows a set of standing instructions from the account holder to deliver acquired securities to a custodian, to pay proceeds to a designated institution, or to receive funds from a designated institution to settle a trade. Presently, when sale transactions occur in a DVP account, the transactions are exempt from IRC §6045 reporting under Reg. §1.6045-1(c)(3)(iv) by the executing broker. Under these rules, the DVP broker transfers the sale proceeds as instructed to another financial institution with the presumption that the broker who receives and posts the proceeds to the owner's account will do the tax reporting.

It is important to note that DVP accounts never involve custody. DVP accounts are used to effect executions of buy and sell orders. Cash on delivery (delivery versus payment or DVP) means that cash and securities are produced on settlement date to close the trade. Where purchases are made through DVP accounts, the cash is delivered from a banking source to settle the trade, and the acquired shares are immediately shipped to a custodian or transferred to a custody account with the same broker pursuant to a standing DVP order to do so. Securities are never retained after purchase in a DVP account.

Where sales are executed, the securities to be sold are transferred by the custodian to the DVP broker after the order is executed (after trade date), but before settlement date to settle and close the sale. On settlement date, proceeds are delivered out by the DVP broker wherever instructed pursuant to a standing order. DVP accounts are used in institutional trading and many times, the beneficial owner is exempt from Form 1099 reporting altogether, for example, as a qualified pension plan or as a bank or brokerage firm. It is also important to note that the broker holding the DVP account (the DVP broker) does not always know who the beneficial owners are, or which portion of the transferred shares relate to any particular beneficial owner since these owners do not actually hold the account with the DVP broker. For the most part, it is another financial institution or investment advisor that opens the DVP account and sets the trade instructions. Currently, if there is a gain/loss system tracking tax lots for beneficial owners, it could be maintained by any number of persons responsible for developing the customer tax statement, including the custodian (which can be a clearing broker), an investment advisor, a CPA or even a tax return preparer. A significant percentage of daily trades everyday take place through DVP account relationships. Because the volume is so high, this method of trading needs to be expressly addressed in the final regulations.

[15] Cash on delivery transactions (also known in the industry as the RVP/DVP exception): In the case of a sale of securities through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale. If, however, the broker's customer is another broker (second-party broker) that is an exempt recipient, then only the second-party broker is required to report the sale." [Reg. §1.6045-1(c)(3)(iv)] Like the multiple broker rule, this rule is actually a deferral rule that requires the final broker in the chain who is responsible for paying the holder or crediting the gross proceeds on the sale to that holder's account to report the sale on Form 1099-B.

In a DVP setting, there are two different transfers of securities to consider for purposes of the transfer statement provisions: transfers of a custodian to a DVP broker to close a sale and transfers by a DVP broker of purchased securities. For sales transactions, at issue is whether a transfer statement will be required when a custodian under instructions transfers securities to the DVP broker to settle a sale even though the DVP broker would have no Form 1099-B reporting responsibilities for the sale. It is important to note that not every custodial broker that is told to transfer shares knows that a sale has taken place. Shares can be requested to be transferred for many reasons. The proposed regulations provide that every transfer of custody effected by an "applicable person" to a broker or other professional custodian of any share of stock in a corporation on or after January 1, 2011, that is not a sale, is a transfer of a covered security for which the applicable person must provide a transfer statement. Under the proposed regulations, an "applicable person" is a broker within the meaning of Reg. §1.6045-1(a)(1) and is defined to include any person that acts as a custodian of securities in the ordinary course of a trade or business, any issuer of securities, and any agent of these persons. It is unclear from the regulations whether (1) the delivery of shares by a custodian to a DVP broker is part of an integrated transaction that is a sale or (2) the sale and delivery by the DVP broker are separate transactions such that the delivery by the custodian is a transfer “in a transaction that is not a sale.” If the former, no transfer statement would be necessary; if the latter, a transfer statement would be required.

Although the custodian that transfers securities to settle a DVP sale is usually a "custodian" as understood under Reg. §1.6045-1(a)(1), where the custodian has knowledge that securities have been sold, the transfer statement requirement may not attach since the transfer could be considered part of a sale of the securities. If the custodian will be receiving the proceeds back from the sale and reporting the sale to the beneficial owner on Form 1099-B, an exemption may be warranted since the custodian that reports the sale on the Form 1099-B has the basis information and it would be superfluous to send it to the DVP broker who is exempt from Form 1099-B reporting. Where the custodian is not the Form 1099-B reporting broker and is unaware of the sale context, then a transfer statement may be warranted.

In a purchase transaction, transfer statements need to be considered when a DVP broker delivers securities acquired through a DVP account out to the custodian. Legally, DVP accounts cannot hold custody. However, for the split second a DVP broker holds the purchased securities in "street name" for the period of time it takes to transfer them to the custodian, there could be considered a custody relationship for tax purposes. It is unclear from the regulations whether (1) the delivery of shares by a DVP broker to the legal custodian is part of an integrated purchase transaction that is not considered one of a custodian on the part of the DVP broker under Reg. §1.6045-1(a)(1), or (2) the purchase and delivery by the DVP broker are separate transactions such that the delivery by the DVP broker is a transfer by a custodian “in a transaction that is not a sale.” If the former, no transfer statement would be necessary; if the latter, a transfer statement would be required on the part of the DVP broker. IRPAC thinks that in the context of a DVP broker's transfer of purchased shares to a custodian, the DVP broker may fall outside the scope of "applicable person" required to send a transfer statement, since DVP brokers are not technically "custodians." If the intent of the regulations is the latter case, we note that the DVP broker does not know who owns which portion of the transferred shares, and thus could not provide to the clearing or custodial broker the information required in a transfer statement as proposed in the regulations. The DVP broker can only provide confirmation of a bulk trade which would have no bearing on the actual owner's share of the underlying trade.

Recommendations: IRPAC requests that the Service provide clarification regarding the application of the regulations to DVP arrangements, specifically regarding whether the delivery of shares by a DVP broker in a purchase transaction to another financial institution is a transfer of covered securities for which the DVP broker would be required to provide a transfer statement. If the delivery of the shares is considered such a transfer, the Service will need to consider the fact that the DVP broker will be unable to provide to the clearing or custodial broker the information required in a transfer statement regarding specific beneficial owners. IRPAC also recommends that the Service exempt a custodial broker transferring shares to a DVP broker to clear a sale in a DVP account from the transfer statement requirements, in particular where the custodian is the broker reporting the sale proceeds to the beneficial owner on Form 1099-B with appropriate gain or loss information.

E.2. Application of the Multiple Broker Rule.

The biggest difference between the DVP rule and the "multiple broker rule" lies in the fact that the executing broker in the "multiple broker rule" almost always knows who is the beneficial owner of the account and usually maintains an account in the beneficial owner's name on it books. The "multiple broker rule" allows priorities to be established based on the structure of the trading relationships in support of the beneficial owner. If a broker is instructed to initiate a sale by a securities or commodities dealer, a bank or a futures commission merchant (that is, an introducing broker), no return of information is required with respect to the sale by that introducing broker. Only the broker that credits the gross proceeds to the holder's account is to report the trade on Form 1099-B. Similarly, when stock is redeemed or securities retired, only the broker responsible for paying the holder, or crediting the gross proceeds to that holder's account, is required to report the sale. [Reg. §1.6045-1(c)(3)(iii)]. From an industry standpoint, the multiple broker rule results in only the clearing broker (the broker that is responsible for posting the proceeds to the holder's account) reporting the sale on Form 1099-B.

If the clearing broker also holds custody, it would be the clearing broker that would effect any transfer of the securities to another financial institution and would be accountable for the transfer statement under the proposed regulations. However, in today's financial services industry, the clearing broker does not always hold custody for the introducing broker and this gives rise to a need for some rule like the "multiple broker rule" in the context of transfer statements. Many introducing brokers allocate custody responsibilities to different institutions, but give the trade execution and processing responsibilities to a clearing broker. In addition, a clearing broker can reallocate assigned custody functions to another institution, but keep the trade execution and processing components under its name. Where either occurs, the custodian would probably use

ACATs to transfer securities should the customer move the account to another broker (or when the introducing broker chooses another clearing broker requiring custody transfer) and fall under the transfer statement rules even though the clearing broker with the account maintenance function, holds the information required on the transfer statement, that is, the tracking of tax lots and basis information for the holder. The better party to complete the transfer statement would be the clearing broker. Without a priority rule similar to the "multiple broker rule" for transfer statements, the responsibility for the transfer statement in these cases would remain unclear.

Note that there can be custody changes that do not involve a change of the clearing broker, but would require the transfer of securities. Under the "multiple broker rule" if one were to be implemented, since the clearing broker with tax reporting responsibilities has not changed, there is actually no transfer as to the holder's account and there may be no need for a transfer statement at all. Clearing brokers usually retain maintenance for the tax lot accounting and will drop the execution tickets on orders from the introducing broker as well as continue to produce the statements and confirms even where the custodian changes. Custody has no bearing on these functions.

The broker that has accountability for account maintenance will be in the best position to produce a correct transfer statement when required and that broker is usually the same party under the existing rule responsible for Form 1099-B reporting for security trades as well since they execute trades for and posts to the holder's account. Without adoption of some form of "multiple broker rule", the named custodian may have the transfer statement requirements even though they do not have the data base to correctly relay the information and may be required to produce a transfer statement even where one may not really be needed. The relationship between clearing and introducing brokers is contractual and varies widely regarding who assumes which tasks and tax reporting rules need to take these points into consideration.

Recommendations: IRPAC recommends that the multiple broker rule be adopted for both IRC §6045(g) and §6045A purposes, designating the party who has accountability for posting the transactions to the holder's account to be responsible for providing transfer statements to a new broker when required. It will be important that basis information be reported by the same broker that has contractual responsibility for tracking purchases and for reporting the sales proceeds. The broker responsible for Form 1099-B reporting should also assume responsibility for any transfer statements should securities need to be transferred since that broker usually would be responsible for directing the actual transfer.

F. Transfer statements - wash sales, short sales and other unique basis adjustment considerations

F.1. Resolve how to coordinate transfer statement processing with issuer corporate action reporting, as well as with other basis adjustments already required to avoid duplicate broker adjustments when accounts are transferred.

The proposed regulations do not specify how transfer statements provided to brokers should address issuer adjustments for reclassification of returns of capital, and for wash sales, short sales, straddles and other adjustments that are embedded in the basis information provided on the statement. They also do not address how the wash sale rules are to be applied after the transfer.

There currently exist uniform broker-to-broker information transfer standards (ACATs) and a system to accomplish relay of transfer statement information. The system is Cost Basis Reporting System (CBRS) maintained by DTCC. Typically once an account transfer is approved the assets are moved and the cost basis information must follow within 3 days. Usually this is the next business day. This means there is a rigorous current state of the art industry standard to push this information along. Where focus needs to be given is in what is needed to accommodate transfer statements for those transferring securities outside the ACATs program and where there are processing inconsistencies that need to be researched. By enforcing a more rigorous standard on issuers to provide information more timely, there will also be fewer instances of unadjusted basis due to corporate actions flowing between financial institutions. These are far better strategies to pursue than to require an endless updating process.

Recommendations: The final regulations need to provide protocols for notifying brokers in transfer statements that issuer adjustments, such as the reclassified returns of capital, and adjustments for wash sales, short sales, straddles and other required adjustments have already been made in the basis numbers passed in the transfer statement. The manner in which the wash sale rules should be applied going forward after such a transfer also needs to be clarified.

In addition, protocols are necessary for informing receivers of transfer statements of any need for newly identified retroactive basis adjustments on already transferred securities.

Some basis adjustments, if not made at the time of the transfer by the transferring broker may be lost when securities are moved from one broker to another, particularly after 18 months or more have passed since the transfer. Points to consider:

- Adjustment information may become available to a Form 1099-B provider after the Form 1099-B has been provided to the client for the year involved (sometimes several years after). Consideration needs to be given to establishing reasonable de minimis thresholds to waive corrections under certain dollar thresholds. IRPAC recommends a threshold that exempts updating transfer statements where adjustments are under $10. Even interest is not reportable on Form 1099-INT if the annual amount is less than $10. The cost of supporting an endless updating process would far outweigh any tax revenues obtained.

- File transfer layouts will need to be determined that contemplate year end and later corrections of transmitted data.

– Industry groups should be engaged to discuss methodology as some may have instituted programming successfully and can advise. Trying to address all issues simultaneously will result in a suboptimum return on investment and less impact on reducing the tax gap.

– Consideration needs to be given to capping transfer statement corrections for events that become known more than 18 months after the original transfer statement has been sent. Following industry lead, the likelihood of the adjusted statement information reaching the right financial institution up the chain after 18 months is severely reduced looking at the volatility in the market place. Again, the cost and burden of supporting an endless updating process would far outweigh any tax revenues obtained.

Since success of CBRS will be critical to the deployment of the cost basis reporting regime, the Service should focus on those matters currently blocking success of this project. Since these regulations will not become final in time to support certain key programming efforts, an extension of time needs to be granted to allow for a successful deployment of this project. Existing CBRS participants will have only months to complete the programming necessary to adapt to the new CBRS system, which that cannot be finalized until after final basis regulations are issued. In addition, very little focus has been given to handling potentially thousands of applicable persons who do not currently participate in CBRS. These non-CBRS participants may represent 30 – 40 % of all transfer volume. ***Certainly the addition of gift and inheritance requirements has seriously complicated these efforts and consideration should be given to extending the effective dates for these rules out to 2013. See comments above. In addition, the lack of limitations on correcting previously passed data has added enormous constraints to existing implementation plans. See our suggestions for a reasonable application of limitations above.***

F.2. <u>Presumption that security is covered.</u>

Under Prop. Reg. §1.6045-1(d)(2)and §1.6045A-1(b)((2), a transferred security will be presumed to be a covered security unless the transfer statement expressly states that the security is a noncovered security.

Recommendations: Where securities are transferred before the effective date of the regulations for the type of security involved, they should be presumed noncovered.

F.3. <u>Corrected transfer statement should not always require corrected Form 1099-B.</u>

If a broker receives the information required on the transfer statement after reporting the sale of the security on Form 1099-B, the proposed regulations require the broker to file a corrected Form 1099-B within 30 days if the original reporting was incorrect or incomplete. Similarly, if an issuer furnishes the issuer action statement after the broker has reported the sale of the security on Form 1099-B, the proposed regulations require the broker to file a corrected Form 1099-B within 30 days to report any adjustments to basis not reflected previously. Commentators requested that corrected reporting not be required for de minimis adjustments or for statements furnished beyond a specific period after the close of the calendar year. The proposed regulations do not adopt either suggestion. See Prop. Reg. §1.6045-1(d)(2). In addition, a person providing a transfer statement based on another transfer statement that they received who later receives a correction in the earlier transfer statement, must furnish a corrected statement within 15 days of receipt of the other corrected statement. See §1.6045A-1(c). This will pose an enormous burden to brokers particularly if more than a year has passed since the security sale was reported, or where the account has subsequently been closed. Not all accounts are transferred, many are cashed out and contacts with the customer may have become stale. Moreover accounts move from house to house, names change on accounts and over time the viability of tracing customers by passing transfer statements around becomes futile and costly.

Recommendations: The Service should consider adopting rules similar to those now in place for correcting Forms 1099 that are subject to B Notices where closed accounts are given special treatment, and place a cap on transfer statement responsibilities beyond 18 months. See recommendations above regarding transfer statement limitations of less than $10 or after 18 months.

G. Technical support of wash sales

G.1. Certain wash sale reporting exceptions are needed.

Commentators requested exceptions from reporting wash sales resulting in de minimis adjustments, wash sales triggered by scheduled periodic investments such as in an employee stock purchase plan or by automatic dividend reinvestment, or where involving high-frequency trading. Because the underlying substantive rules disallow losses in these situations, and because in the view of the Treasury and the Service reporting should occur without regard to the mark-to-market method of accounting, the commentators' recommendations were not followed and no exceptions were provided. See the Preamble to the proposed regulations. Wash sale calculations are tedious and for day trading, or small dividend reinvestments, for example, the cost of calculations may be very high in comparison to the tax reward uncovered in the application. This added to the fact that the loss must be separately reported for each and every event seems to make for a very cumbersome and expensive process for both the Service and the broker.

Recommendations: Reconsideration should be given to the comments and suggestions already received in this area. In IRPAC's June 23, 2009, supplement to our comments on cost basis reporting, we recommended that Service and the industry consider how to treat professional traders who are not subject to wash sales rules. Brokers currently have no method of clearly identifying any professional trader (a day trader who meets the broader definition) for exception treatment. It is unclear to what extent broker-dealers have programming in place to identify traders and where this has been programmed for it would likely be to an industry standard such as New York Stock Exchange definition.

IRPAC suggested consideration be given to exempting day traders in general from the basis reporting rules, particularly those that elect to be subject to mark-to-market taxation. Many brokers do not have robust systems to track basis in fast moving trading currently that is part of today's day trader market activities. This is true whether or not the trader qualifies and elects mark-to-market taxation. It is hoped that the Service can accept the brokers' fairly universal systemic limitations as the cost to build a cost basis tracking system will be foreboding, particularly regarding the wash sale applications. IRPAC still suggests that the Service consider a threshold exemption from cost basis reporting for accounts that average more than 25 trades a day over a calendar year. In the alternative, the Service could consider building an exemption around the qualifications for making the mark-to market election. See IRS Pub. 550, p.72. Brokers can incorporate the exemption language in their trading agreements.

G.2. **Other considerations that need to be addressed press for an extension of the effective date for application of wash sale rules.**

Open wash sales issues to consider in addition to those already discussed elsewhere in this letter:

- IRPAC pointed out in our previous comments that the sheer volume of repurchases from dividend reinvestments will make wash sale transactions unmanageable unless reasonable limitations are deployed. We note that there is also a consideration regarding the standard practice of many paying agents that regularly sell off unsupportable fractional shares that may generate a wash sale (of a nominal amount) through no fault of the investor. Rules need to be issued that consider these aspects that make the process more reasonable and less costly to implement.
- It is important to recognize that yearend adjustments can create cascading adjustments to wash sales. Without appropriate limits placed on de minimis dollar amounts or appropriate time limits placed on these adjustments, wash sale programs can run haywire in trying to carry these adjustments back over long periods of time. Quality controls will be impossible to establish, particularly since the tax characterization change, as a tax event, generally is separate from the events recorded in a broker's books and records (cash flows and confirmations), which anchor quality controls.
- Application of wash sales between covered and uncovered securities held in the same account with the same CUSIP will be difficult to manage since uncovered securities are treated as held in a separate account. Similarly, treatment of DRP and non-DRP securities with the same CUSIP for wash sale rules needs to be clarified.
- Apparently, there is no current vendor that sells a product that is fully compliant with the proposed regulations and it is doubtful that this can be accomplished for any system by the January 1, 2011 implementation date.

H. **Managing the complexities of short sale basis reporting**.

H.1. New reporting rules that will disallow 2010 reporting on Form 1099-B of short sales opened in 2010 that remain open after 2010 need to be eliminated and additional time is needed beyond 2011 to handle the unique basis adjustments that short sales require.

The rules relating to short sales in Prop. Reg. §1.6045-l(c)(3)(xi) and Prop. Reg. §31.3406(b)(3)-2 should be given an extended effective date to at least January 1, 2012. More importantly, the staging of short sale implementation caught many off guard and they are unprepared to earmark the short sales occurring in 2010 as required in the proposed regulations. In the case of a short sale, IRC §6045(g)(5) provides that gross proceeds and basis reporting are required for the year in which the short sale is closed rather than the year in which the short sale is entered into (the method that is currently used). This provision generally is effective on January 1, 2011. The proposed regulations implement this change in reporting of short sales by requiring brokers to report all short sales *opened on or after January 1, 2010*, for the year in which the short sale is closed.

Recommendations: There should be a clear break in reporting with short sales entered into before 2011 and reported under the method required prior to the new legislative change and those entered into after 2010 reported under the new rules. In addition, the effective date should be extended to 2013. As pointed out regarding the handling of disallowed losses and other short sale adjustments through this letter, an extended 2013 effective date is needed to handle the many complex short sale calculations that have not been programmed as of yet as an industry standard, that will need to be considered in some development process that will take time and will require additional testing to assure accuracy since these details are not currently part of a broker's books and records.

H.2. Reporting for adjustments in basis from short sales needs to be considered.

In a short sale, there is usually a securities lender who loans the shorted security to the seller for settlement of the short sale. Over the open period of the short sale, the seller pays the lender in lieu dividends to replace the loss of dividends from the loan as well and also pays loan fees. If the seller closes the short sale by the 45th day after the date of the short sale (1 year or less in the case of an extraordinary dividend so these will also need to be tracked—see discussed in the first section of this Part IV above), the seller cannot deduct the payment in lieu of the dividend that is made to the lender of the securities. Instead, the taxpayer must increase the basis of the stock used to close the short sale by that amount. This will mean tracking the substitute payment details so that adjustments can be made. Other points to consider:

- The period a short sale is kept open does not include any period during which the taxpayer holds, has an option to buy, or is under a contractual obligation to buy substantially identical stock or securities. This will mean developing a system to identify when such events occur and to tracking the tolling of this holding period. The broker should be able to assume that no such positions exist if they are not entered into through the same account looking to Prop. Reg. §1.6045-

1(d)(6),(7); however, the programming covering this consideration even if within the same account is still fairly complex.

- If there is a substitute payment made for a liquidating distribution or nontaxable stock distribution, or if the taxpayer buys additional shares equal in value to a stock distribution issued on the borrowed stock during the short position, the payment or stock cost are capital expenses and must be added to the basis of the short sale and reported on the close of the short sale.

- Where deductions for payments of in lieu of dividends are disallowed, there is a complex calculation that must be made to limit the disallowance only to the extent the payments exceed amounts received as ordinary income from the lender of the stock for the use of collateral with the short sale. This exception, however, does not apply to payments in place of extraordinary dividends so they will need to be identified and tracked separately.

Recommendations: IRPAC believes that considerations should be given to how these matters will be disclosed on Form 1099-B and in transfer statements to avoid duplicate reporting in the taxpayer's return and double accounting in a security transfer. IRPAC believes that many financial institutions will be unable to track and correctly report the complexities of these transactions and that it may be better to require these adjustments to be made in the seller's tax return.

H.3. <u>Short-sale backup withholding treatment.</u>

The proposed regulations modify the backup withholding rules for short sales to provide that backup withholding can occur only at the time the short sale is closed. See Prop. Reg. §31.3406(b)(3)-2(b)(4).[16]

It is noted that these rules do not follow the cash flow, and that funds may not be available at closing to effect the withholding.

[16] Reg. §31.3406(b)(3)-2(b)(4): (i) *Amount subject to backup withholding*. The amount subject to withholding under section 3406 with respect to a short sale of securities is the gross proceeds (as defined in §1.6045-1(d)(5) of this chapter) of the short sale. At the option of the broker, however, the amount subject to withholding may be the gain upon the closing of the short sale (if any); consequently, the obligation to withhold under section 3406 would be deferred until the closing transaction. A broker may use this alternative method of determining the amount subject to withholding under section 3406 with respect to a short sale only if at the time the short sale is initiated, the broker expects that the amount of gain realized upon the closing of the short sale will be determinable from the broker's records. If, due to events unforeseen at the time the short sale was initiated, the broker is unable to determine the basis of the property used to close the short sale, the property must be assumed for this purpose to have a basis of zero. (ii) *Time of backup withholding.* The determination of whether a short seller is subject to withholding under section 3406 must be made on the date of the initiation or closing, as the case may be, or on the date that the initiation or closing, as the case may be, is entered on the broker's books and records.

Recommendations: It is presumed that the Service intended that the payer receive the withholding from the payee from another source, but this approach rarely works for many reasons: the customer has no funds left after margin is met, there is no free cash in the account, the customer is fully invested and refuses to allow a liquidation to meet the tax bill, the account has been closed and the customer refuses to pay the due bill, etc. A payer that elects to withhold under IRC §3406 from an alternative source may determine the source from which the tax is to be withheld, including allowing the payee to provide a check, or may allow the payee to designate the alternative source under Reg. §31.3406(h)-2(b). If this approach is to be taken, there should be a cross reference added to Prop. Reg. §31.3406(b)(3)-2(b)(4).

H.4. <u>Consideration of how the cash flow will work in a short sale.</u>

In a short sale transaction, the customer borrows shares and sells them on the market expecting that the share price will decrease and they will be able to buy the shares back at a lower price. The proceeds of the sale are deposited into the short seller's margin account. While the initial margin requirement is the amount of money that needs to be held in the account at the time of the trade, the maintenance margin is the amount that must be in the account at any point after the initial trade. Under Regulation T, the Federal Reserve Board requires all short sale accounts to have 150% of the value of the short sale at the time the sale is initiated. The 150% consists of the full value of the short sale proceeds (100%), plus an additional margin requirement of 50% of the value of the short sale. For example, if a customer initiates a short sale for 10,000 shares at $10, the value of the short sale is $100,000. The initial margin requirement is the proceeds $100,000 (100%), along with an additional $50,000 (50%), for a total of $150,000. Initial margin is only the amount required in reserve when the trade first takes place. After that point, margin is adjusted based upon the maintenance margin rules. Amounts of margin under the maintenance rules can cause the initial margin amount to be further adjusted up or down from the initial margin requirement, freeing margin capital or requiring additional amounts to be posted depending upon the market movement in the security that was shorted.

Maintenance margin requirement rules for short sales add a protective measure that further improves the likelihood that the borrowed shares will be returned. In the context of the NYSE and NASD, the maintenance requirements for short sales are 100% of the current market value of the short sale, along with at least 25% of the total market value of the securities in the margin account. Brokerage firm can and do set higher limits of 30-40%. For purposes of effecting 28% backup withholding on a closing transaction, the problem is that the margin requirement is based on the current value, not the original value so there will be not enough excess cash over margin to effect the withholding. For example, if the customer sells short for a value of $100,000 as in the example above, the initial margin requirement is $150,000. If the broker has a 130% maintenance margin, and the value of the short sale goes down to $20,000, the maintenance requirement drops to $26,000. If the customer buys in the short at that point, there is only $6,000 left to cover the 28% backup withholding on the sales proceeds, which would be $28,000

($100,000 x .28). Thus, the available cash in the margin account would be substantially less than 28% of the original amount of the short sale, or even 28% of the $80,000 gain ($22,400).

When an individual has a long position in stock (holds the stock in the brokerage account) and then sells the same stock short ("short against the box"), a separate margin requirement is applicable. When shorting a position that is long in an account the requirement is 5% of the market value of the underlying stock. Again, margin fluctuates with the market value of the stock.

Recommendations: Most financial institutions, at this point, want withholding to follow the cash flow and apply at point of sale which would mean some form of Form 1099 reporting would need to continue to report the withholding where the short sale remains open over yearend. We have been told that most financial institutions are not set up to escrow tax funds and would deposit the withholding on a current basis.

With Reg. §31.3406(b)(3)-2(b)(3) restricting backup withholding to excess margin amounts, where margin is greater than the cash flow on the trade as demonstrated above, there still may not be enough cash to cover the withholding. Under this regulation, the amount required to be withheld with respect to the sale is limited to the amount of cash available for withdrawal by the customer immediately after the settlement of the sale. For this purpose, the amount available for withdrawal by the customer does not include amounts required to satisfy margin maintenance under Regulation T, rules and regulations of the National Association of Securities Dealers and national securities exchanges, and generally applicable self-imposed rules of the margin account carrier. Thus, such amounts are not available for withdrawal by the customer. Once the security is acquired and margin limits no longer apply, then also as demonstrated above there may not be enough cash flow to cover the 28% withholding even if applied only to the gain unless the short is against the box where the stock is already paid for. Remember that the long position in stock may also be bought on 50% margin further reducing cash flow. We have struggled with these scenarios and have not found a solid solution to the concern.

Recommendations: We suggest that the Service work with SIFMA to determine whether a common position can be developed for the majority of brokers that would allow backup withholding to take place whenever there is excess value in the account over the open period rather than only at the front or only at the closing. Caution is warranted as a collection of excess cash could cause a later margin call should stock prices shift that increase the margin amount.

I. Communications between brokers and customers/ taxpayers

I.1. Clarity is needed in how and when to communicate a broker's default cost basis method to customers.

The proposed regulations do not specify a method for brokers to communicate their default basis determination method to taxpayers or the time for this communication.

IRPAC appreciates that this may leave the door open for a wide degree of flexibility in how accounts will be managed under these new rules. The proposed regulations also do not specify a communication method or time limitation on communicating to a customer the broker's decision to elect a default method (i.e., FIFO or average cost) for covered RIC / DRP shares where the customer does not make an election. At issue is whether there are any restrictions on whether the broker may elect a different default method for each account, or whether the broker must choose one default method for all of its accounts.

Recommendations: IRPAC is in favor of the open-ended way the Service has addressed communication issues between financial institutions and their customers. However, we would like a confirmation that we are reading these rules correctly and that there are no restrictions imposed on whether the broker may elect a different default method for each account, or whether the broker must choose one default method for all of its accounts. If there are points we are missing, then we suggest that the provisions be embellished with examples.

J. Components of dividend reinvestment plan reporting

J.1. A plan qualifies as a DRP if the plan documents require that at least 10 percent of any dividend paid be reinvested in identical stock.

Assuming this 10 percent requirement is met, a plan may reinvest different percentages of dividends in different stocks. Moreover, the proposed regulations provide that a stock may be held in a DRP even if no dividends have ever been declared or paid or the issuer has ceased paying dividends. This very liberal rule seems to allow averaging of any equity as long as the DRP requires that at least 10% of whatever is paid is reinvested. However, the proposed regulations do not define dividends. The preamble to the proposed regulations requests specific comments on whether and how the regulations should define dividends, such as whether the regulations should define the term by reference to IRC §316, or define the term more broadly to include any payment or distribution from stock, including ordinary dividends, capital gains dividends or distributions, non-taxable returns of capital, and cash payments in lieu of fractional shares.

Recommendations: The broader rule in defining dividends should be used that does not restrict the terms by IRC §316 and that would include any payment or distribution from stock, including ordinary dividends, capital gains dividends or distributions, non-taxable returns of capital, and cash dividends in lieu of fractional shares. The broader rule would make better sense since many DRPs now reinvest all cash distributed. Prop. Reg. §1.1012-1(e)(6).

J.2. Elimination of double category averaging.

The proposed regulations provide that average basis is computed by averaging the basis of all identical stock in an account regardless of holding period, and include a transition rule that requires taxpayers using the double-category method to average the basis of all identical stock in an account on the date of publication of final regulations. Specific comments are requested on whether the double-category method should be retained. Prop. Reg. §1.1012-1(e)(7).

Recommendations: Consistent with industry comments, we believe that elimination of the double category method is a good strategy and will greatly simplify the process.

J.3. Revoking the averaging method has time limits and differs from changing the averaging method which has no time limits.

The proposed regulations provide that the revocation of the average basis method election must occur by the earlier of one year from the date of making the election or the first sale or other disposition of the stock following the election. On the other hand, the proposed regulations provide that a taxpayer may change from the average basis method to another permissible method at any time. The proposed regulations clarify that a change in basis determination method is a change in method of accounting to which the provisions of IRC §446 and §481 and the associated regulations apply.

Recommendations: It will be difficult for brokers to distinguish the difference between these two actions and more examples and explanations are needed. How will the broker know in a change that the Service's permission is needed and has been acquired?

K. Communicating specific identification in a "timely manner"

K.1 Examples are needed to illustrate "timely manner".

Reg. §§1.1012-1(c)(3)(i)(b) and (ii)(b) currently require a broker or agent to provide written confirmation, within a reasonable time after sale, of the sale of stock a taxpayer has specifically identified. The Service did not amend this requirement, stating that it "ensures that taxpayers receive necessary information in a timely manner." What is reasonable depends on the facts and circumstances, so it may be that the monthly or other customer statement would be considered an acceptable vehicle. The proposed regulations do clarify that a written confirmation, record, document, instruction, or advice includes writing in electronic format. See Preamble to proposed regulations and Prop. Reg. §1.1012-1(c)(8)and (9).

Recommendations: IRPAC recommends that the Service provide as an example in the final regulations that notifications in monthly or other customer statements would be considered acceptable vehicles for this communication.

It would also be very helpful for the Service to develop a taxpayer booklet that explains the different elections for basis calculation and how to make the elections in a way that ties to the broker reporting requirements. Currently the information is imbedded in many different publications. See Pub. 551, *Basis of Assets*; Pub. 550, *Investment Income and Expenses,* and Pub. 564, *Mutual Fund Distributions*. It would also benefit taxpayers if the Service updated these publications to reflect the new basis reporting rules.

L. Handling high frequency traders

L.1 Further study is required to determine best way to handle high frequency traders.

The Treasury Department and Service have requested further comments on the treatment of high-frequency traders, including specifics about the burden that basis reporting may impose, and how brokers can identify customers that have made valid and timely mark-to-market accounting method elections under IRC §475(e) or (f) and which transactions by these persons are subject to the provisions of IRC §475.

Recommendations: We are exploring further comments in this area, but understand that many financial institutions have indicated that their processes may not be robust enough to handle wash sale and other basis adjustments for high-frequency (day) traders. Limitations need to be considered, and we suggest that the Service work with the critical trade associations that can help identify reasonable limitations. Where traders are subject to IRC §475 and to mark-to-market methods, many brokers have indicated that they will not be able to support any form of mark-to-market reporting and would prefer to continue to report the sales on Form 1099-B, but will struggle to keep up with basis adjustments.

M. Issuer action statements not sufficient

M.1. A clearing facility is needed to ensure uniform classification of the same security by multiple brokers.

In practice, it is often difficult to determine whether a security is classified as debt or stock. The proposed regulations provide that for purposes of determining whether a security is covered for basis reporting, any security that an issuer classifies as stock is treated as stock and is subject to the applicable rules. If no issuer classification has been made, the security is not treated as stock unless the broker knows, or has reason to know, that the security is reasonably classified as stock under general tax principles.

This approach is not helpful as many times issuers do not make classifications clear in new issues. In addition, this approach will lead to different classifications of the same security by different firms. Brokers will need to be prepared to validate all inbound transfers against their own stock records to assure no conflicts and, where there are conflicts, resolve them usually by use of third party information. See Prop. Reg. §1.6045-1(a)(14). IRPAC still believes that review of issuer statements is not sufficient and that a clearing facility needs to be established to handle this information and that the regulations should encourage such an effort.

The proposed regulations provide that for an issuer, both the return filing and information statement requirements under IRC §6045B are waived if the issuer posts a statement with the required information in a readily accessible format in an area of its primary public website dedicated to this purpose, by the same due date for reporting the organizational action to the Service, and keeps the form accessible to the public. Under the proposed regulations, this public reporting relieves the issuer of its duty both to file the return with the Service and to furnish the statement to its nominees and certificate holders. Currently when issuers post notices on their websites, they are frequently not found. Website addresses are not common knowledge, rendering the search for these events an extremely cumbersome hit-and-miss process for which there is no formally recognized clearing facility. Where international securities are involved, such global web searches are fraught with pitfalls including language barriers and system compatibility issues. In these proposed regulations, the Treasury and Service expressly declined to offer support for a formally recognized clearing facility. See Prop. Reg. §1.6045B-1(a)(3) and (b)(4).

Recommendations: IRPAC recommends that the Treasury and the Service reconsider support of a formally recognized clearing facility. It is our belief that without such a facility, brokers will not have access to the information necessary to comply with cost basis reporting rules for many types of securities.

IV. Remaining Cost Basis Comments

Appendix F
Cost Basis Current Industry Practice – Supplement to Comments on Examples Involving the DVP and Multiple Broker Rules (June 8, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

June 8, 2010

Mr. Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (Notice 2009-17)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue N.W.
Washington, DC

Re: Cost Basis Current Industry Practice – Supplement to Comments on Examples Involving the DVP and Multiple Broker Rules

Dear Mr. Schaeffer:

The Information Reporting Program Advisory Committee (IRPAC)[i] appreciated the opportunity to answer some of your questions on current industry practices in our conference call of May 20, 2010.

As discussed in the call, IRPAC is concerned that the lateness of releasing final regulations on cost basis reporting will so shorten system development time that many financial institutions will be unable to make the necessary changes in time to be compliant with the new rules based on the originally scheduled effective date of January, 2011 for equities. Although amounts are not technically Form 1099-B reportable to the Internal Revenue Service and to customers until 2012, the systems will need to be fully deployed January 1, 2011, in order to capture the necessary trading information to enable the reporting. Moreover, the transfer statement process could be triggered at any time throughout the tax year, 2011.

As pointed out in our comment letters both in 2009 and earlier this year, the likelihood that affected parties will be able to implement new regulations in less than 6 months time is slim. Even if the regulations are finalized in the next few months, the necessary guidance will not have been made available in time to guide required system development and provide time for testing of system changes. In addition, there will not be sufficient time to educate financial institution staff and their customers. There are many implementation details that remain ambiguous or that are impossible to implement in the remaining time frame.

[i] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

IRPAC continues to recommend that serious consideration be given to delaying the implementation of these provisions to 2012, particularly as they apply to transfer statements; and to deferring enforcement of the gift and inheritance provisions to 2013. Provisions should also be made for penalty relief in the first few years of the new regime, in recognition of the following: (1) Complex systems development will take several years, and in some cases will require changes to the underlying trade processing systems; (2) The recent economic downturn has affected the financial services industry particularly hard so that funds needed for systems development and training are limited or not available; (3) Developmental issues are fairly complex, even on matters as simple as determining who owns needed data, and it will take time to work through the interrelated processes; and (4) Financial service providers are traditionally not tax return preparers.

We also wanted to reaffirm with you, as pointed out in our recent conference call, as well as in previous discussions and comment letters that it is imperative that the new regulations speak in industry terms that will make institutional roles clear in compliance accountabilities. This is as true in the context of DVP and Multiple Broker transactions as in the context of who is an "applicable person" to which the transfer statement responsibilities, as well as other accountabilities apply in general, as pointed out in our comments to you, dated March 3, 2010. In any case that a transfer statement is not passed on for a covered security because the transferor does not consider itself to be an “applicable person”, that security will drop out of the reporting process because the receiving broker, after further query, will ultimately be permitted to treat such security as an uncovered security.

As we discussed in our call, it will be imperative that the "applicable person" accountable for providing the transfer statement be that party best equipped to deliver the appropriate cost basis information even if not the actual party that transfers the security. It is far better to use the actual business classifications in defining any responsibilities rather than a blanket statement that exempts "any person that acts solely as a clearing house for the transfer" as the present version of the proposed regulations now read. In this regard, there has been a great deal of confusion over the years regarding the meaning of the term "clearing organization" as the phrase exists currently in Reg. §1.6045-1(b) Example 2 (vii). Initially this exception was intended to cover such entities as the Depository Trust Company, one of the clearing organizations for the U.S. securities industry. In practice, the exception has been extended to cover many other organizations and has lost its clear meaning. Therefore, use of this term in the cost basis regulations needs to be clarified, particularly in the context of a Multiple Broker transaction.

Use of the term "clearing" in and of itself has many different meanings in the securities business. In the norm of today's business meaning, a “clearing broker” processes trades, posts the securities or proceeds to the specific customer's account and produces the statements and confirmations for an introducing broker. Clearing brokers do Form 1099-B reporting under their federal EINs even though they do not have the primary relationship with the customer, and many times also hold accountability for the custody functions even though they are not always the custodial broker. We are certain that you do not intend to exempt clearing brokers from these rules.

Any confusion as to the categories of persons that are or are not “applicable persons” could therefore cause serious gaps in the overall cost basis reporting regime. In addition, certain “applicable persons” are permitted under the proposed regulations to provide more limited information than others on transfer statements; and these rules may also present gaps in the transfer of complete basis information. See our March 3, 2010 comments.

IRPAC appreciates the opportunity to present further comments to you on the proposed cost basis regulations and remains committed to assisting the IRS in finalizing these rules. If any questions, we will be happy to further discuss this with you at our upcoming June meeting.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

Appendix G
IRPAC Additional Comments on Cost Basis Proposed Regulations (July 6, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

July 6, 2010

Mr. Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (REG-101896-09)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue N.W.
Washington, DC

Dear Mr. Schaeffer:

On February 26, 2010, the Information Reporting Program Advisory Committee (IRPAC)[1] submitted a letter to the IRS commenting on the proposed cost basis regulations.[2] Since providing those comments, IRPAC has had the opportunity to further consider the proposed regulations and requests in this letter that the IRS provide clarification in the final regulations regarding the following three additional issues: (1) whether a customer must take an affirmative action to "elect" to the broker's default method for calculating the cost basis of mutual fund or dividend reinvestment plan ("DRP") shares, (2) whether a broker can make a single account election during the one year period in which a customer can revoke an election to use the average basis method, and (3) how the single account election should be applied to joint accounts of a customer. Each of these issues is discussed below.

Customer's Election of Broker's Default Method

The regulations require that, with respect to mutual fund or DRP shares, the customer must use the broker's default method of basis calculation unless the customer elects to use another valid method.[3] The question at issue is whether a customer that is notified of the broker's default method and passively accepts such method has made an "election" to use the broker's default method. Stated differently, is a customer required to make an affirmative election to use the broker's default method, or does a customer make an effective election by passively accepting a broker's default method? The need for clarification arises primarily when a broker's default method is the

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.
[2] REG-101896-09, 74 FR 67009 (Dec. 17, 2009).
[3] Prop. Reg. § 1.1012-1(e)(2).

average basis method, and the customer, as permitted by the regulations, wants to change from the average basis method to the separate basis method.
By way of background, the proposed regulations provide that a customer that has "elected" to use the average basis method has until the earlier of its first sale or one year (or such longer period as the broker allows) after the election to "revoke" the election.[4] The effect of such revocation is that the broker is required to "turn back the clock" and recompute the basis of shares as if specific identification method of basis computation had always been in effect for the shares. One of the main benefits of the average basis method is that the separate cost basis of each share generally does not need to be maintained after the share is added to the averaging pool.[5] The proposed regulations seem to acknowledge the practical limits on how long brokers could or should maintain separate basis information by establishing the one year limit for which the customer may revoke its average basis method election (unless the broker allows the revocation beyond the year time frame.)

If a customer's acceptance of the average basis method as the broker's default method is considered an effective election, then the customer's one year period for revoking such election would presumably begin upon such acceptance, and thus limit the time frame for which the broker is obligated to retain the separate basis information of shares purchased by the customer. On the other hand, if customer's passive acceptance of the broker's default method is not effectively a cost basis method election; it is not clear if the customer can change from the average basis method to the specific identification method, and if so, whether there is any time frame for which the customer can switch to the specific identification method. Assuming such a switch were allowed, it is not difficult to imagine a situation where the customer makes monthly purchases of shares in a mutual fund for five or ten years without making any sales before focusing on the issue of the basis determination method. If the customer has passively accepted the use of the average basis method (i.e., the broker's default method), should the broker be required to restore the separate basis of 60 or 120 purchases? This result would seem to undermine the utility of the one year cut-off on revocations. What if the broker no longer has the separate basis information?

The availability of the single-account election is also in doubt when the broker's default method is the average basis method. The single-account election allows the broker to treat all shares subject to the averaging as a single pool even if they are in different accounts. Only the broker can make the single- account election, and may do so only if the customer "elects" to use average basis.[6] If defaulting into average basis is not considered an election, then the broker cannot make a single-account election.

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[4] Prop. Reg. § 1.1012-1(e)(9)(iii).

[5] We note that, regardless of which basis method is used, the proposed regulations seems to require a broker to maintain the acquisition date of all shares purchased for purposes of determining whether a gain or loss on the sale of the shares is long- or short-term at least for five years. *See* Prop. Reg. § 1.6045A-1(b)(1)(vii). Please see the February 8, 2010 comment letter from the Investment Company Institute for further information on this point.

[6] Prop. Reg. §1.1012-1(e)(11)(i).

<u>IRPAC Recommendation</u>: The regulations should be clarified regarding the effect of a customer's passive acceptance of a broker's default method. IRPAC believes that a customer's passive acceptance of the average basis method as the broker's default method should be considered an effective election.

<u>Customer's Revocation of Average Basis Method after Broker Single Account Election</u>

As noted above, a customer that has elected to use the average basis method may revoke such election before its first sale of average basis shares, provided it does so within a year (or such longer period as the broker allows). The proposed regulations also allow a broker to make single-account election with respect to stock for which a customer elects to use the average basis method that is held in separate accounts or treated as held in separate accounts maintained by the customer.[7] A broker's single account election is irrevocable.[8] The election can be made at any time.[9] Thus, it appears that a broker can make a single account election during the one year (or more) period during which the customer can revoke its average basis method election. It is not clear whether the irrevocable nature of the broker's single-account election overrides the revocability of the customer's average basis election.

If the customer can in fact override a broker's single-account election, and revoke the average basis method, there is also the question of how the basis of the single- account election shares should be calculated. When the broker makes a single-account election, noncovered shares for which the broker has basis information may become covered.[10] If the customer revokes the average basis method, do those shares go back to being noncovered?

<u>IRPAC Recommendation</u>: The effect of a single-account election during the period in which a customer can revoke its average basis method calculation should be clarified in the regulations.

<u>Application of Single Account Election of Joint Accounts</u>

The single- account election allows a broker to elect to treat all identical shares of mutual fund or DRP stock held (or treated as held) by a customer in separate accounts as held in a single account. IRPAC requests clarification on the scope of customer accounts that can be covered by the single-account election. Specifically, can the single-account election be made only with respect to accounts held solely by a single customer or can it also be made with respect to joint accounts of the customer, including both spousal and non-spousal joint accounts?

<u>IRPAC Recommendation</u>: The effect of a single-account election on joint accounts should be clarified in the regulations.

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[7] Prop. Reg. § 1.1012-1(e)(11)(i).
[8] *Id.*
[9] Prop. Reg. § 1.1012-1(e)(10)(iv).
[10] See Prop. Reg. §1.1012-1(e)(11)(iii).

IRPAC appreciates the opportunity to present further comments to you on the proposed cost basis regulations and remains committed to assisting the IRS in finalizing these rules. If you have any questions, we will be happy to further discuss this with you.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

Appendix H
IRPAC Comments on Notice 2010-28: Stripping Transactions for Qualified Tax Credit Bonds (May 21, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

May 21, 2010

Mr. Timothy Jones
Office of Associate Chief Counsel (Financial Institutions and Products)
Re: Notice 2010-28
CC:FIP:B5, Room 3547
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Stripping Transactions for Qualified Tax Credit Bonds – Notice 2010-28

Dear Mr. Jones:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to provide comments on Notice 2010-28. This Notice describes regulations that the Treasury Department and the Internal Revenue Service (IRS) expect to issue concerning both stripping transactions for qualified tax credit bonds under section 54A of the Internal Revenue Code and certain income tax accounting matters associated with holding and stripping these bonds. In addition, this Notice describes anticipated related information reporting requirements.

In order to provide easier navigation, IRPACs comments are presented with a table of contents and references to the specific sections of the Notice addressed. IRPAC plans to review the new Forms 1097-BTC and 8038-TC and modified Form 8912 when published and will provide comments as applicable.

Thank you for the opportunity to provide comments on Notice 2010-28. We are available at your convenience to discuss these comments with you and your staff. If you have any questions, please contact the undersigned.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

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[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

IRPAC COMMENTS ON NOTICE 2010-28

1. IRS Notice 2010-28 Stripping Transactions for Qualified Tax Credit Bonds

1.1. CUSIP number requirements 3.03(c)(4)

- The original tax credit bond
- Each tax credit allowance
- At least one separate CUSIP to all rights to receive cash (corpus and coupons still attached)

1.1.1. Permutations not specified

Notice 2010-28 does not anticipate that the interest payment and tax credit allowance associated with a given date might be stripped into a single bundled instrument. Of course the same economic result could be achieved by owning the separately designated tax credit allowance and coupon strip. In these cases, there is the possibility of a tax credit associated with a single date being represented by more than one CUSIP number (the original bond, the stripped credit allowance, the stripped bundle of credit allowance and interest payment). Is there intention to consider this scenario or a similar one in which the interest payments have been stripped from the principal, but the tax credits remain? Current market practice appears to sometimes strip the cash coupons form from the corpus and sometimes not. Any variation appears to be possible.

If you considered that once the bond advances past a credit date, once stripped or actually used by the taxpayer, the remaining elements of the bond are still intact less the spent coupon so there would be no legal reason to treat the bonds differently.

1.1.2. Structured products and foreign issuers

With the desire for robust information reporting around tax credits consideration should also be given to CUSIP number requirements regarding structured products that incorporate stripped tax credits. This type of instrument is, at times, placed privately and the absence of an industry-recognized CUSIP might interrupt the ability of the Service to audit claims of tax credit through multiple nominee levels. Structured products are also discussed in the context of issuer's reporting obligations in section 1.5.2.

There is no legal model currently in place that would support this requirement and CUSIPs are first and foremost legal tracking and generally are not created solely for tax purposes. Where processes are developed internally, they will vary from one institution to another and that will mean no easy way to transfer the required information with the security (bond or tax credit coupons) between institutions.

1.2. Allowance of tax credit to the holder of a stripped coupon 3.03(d)

- From a "strippable" issue
- Must hold whole or proportionate share of the credit, not a variable interest
- Held via a broker or entity specified by the Commissioner

1.2.1. Are the stripped coupons being treated differently from the original bond?

With regard to the prohibition on the variable share of the tax credit allowance, is it intended that this would be permitted if the credit allowance was associated with the original bond rather than a stripped tax credit allowance? This restriction is specified explicitly with reference to stripped credit coupons.

1.2.2. Is there impact on information reporting?

It would be difficult for a financial institution to know (regardless of whether a trust held a tax credit bond or a stripped tax credit), whether trust beneficiaries were receiving proportionate or a variable share of the credit allowance. As long as it is the nominee's responsibility to report the credit and taxpayer's responsibility to determine that the requirements for entitlement are met, appropriate information reporting can be accomplished.

1.3. Aggregation 3.03(e)

- Reassembly of the pieces creates a new aggregated debt instrument unless it includes all the remaining original pieces (see the third bullet point below).
- The aggregated instrument has NQSI, requiring OID computation.
- In the case of a complete reconstitution of the remaining payments and credits of a previously stripped tax credit bond, the resulting aggregated instrument is treated as if it had not been stripped and interest is qualified.

1.3.1. Mechanics of stripping and reconstituting a tax credit bond

In practice, the stripping of tax credits from a given bond is accomplished by the bondholder surrendering the bond to the bond registrar or paying agent in conjunction with written instructions directing the stripping.[1] Since the bonds exist only on a book-entry basis, this activity is transacted by the beneficial owner through the chain of its broker and DTC, the securities industry central depository. In exchange for the surrendered bond, the investor receives the principal strip and Tax Credit Certificates for each of the then remaining tax credits. Those instruments bear the unique CUSIP numbers that were established at the time of issuance. The investor would then be able to separately sell any or all of the components. The stripping and sale of stripped components are, therefore, sequential transactions. Although the taxpayer is expected to treat any aggregation of these remaining stripped components as a new instrument, the reality is that he/she is the owner of a brokerage account that holds a series of separate and distinct stripped principal/interest payments/tax credits because there is no mechanism to actually aggregate the holdings on the books of a broker or other custodian under a single security ID (or to enforce the "purchased on single day" requirement). As a result, the investor must establish a basis in each of the constituent pieces now held to facilitate computation of OID by the broker or custodian.

Conversely, if all the stripped components were all moved into a single account, the broker or other custodian would not recognize this as a reincarnation of the original obligation; it would appear as a portfolio of unrelated assets. This collection of assets would have to be submitted to the registrar for recombination. Following that transaction, the account would be holding the reconstituted bond under its original CUSIP number.

1.3.2. Aggregation via structured products

An alternate scenario is that an investment bank, as the owner of the tax credit bond, submits it to the registrar for stripping and then offers a new structured product that implicitly contains some or all of the stripped components. In this case there would be a unique CUSIP number corresponding to the structured issue. As such, there would also be an offering document that is likely to have the information needed to treat this as an aggregated instrument. This set of circumstances raises the questions about whether an information reporting requirements that apply to the issuers of a tax credit bonds would be applicable to the investment bank that creates the structured product.

1.4. Exception to exempt recipients of interest and OID 4.01

- Corporations
- Securities/commodities dealers
- States, possessions, DC
- REITs
- RICs
- Common trust funds 584(a)
- Trusts exempt from tax under 664(c)

1.4.1. The basic structure of reportability

At brokerage firms, reportability of a transaction is largely determined at the account level, based on an account type classification which does not generally correspond to the granularity of entity types specified. Information reporting is largely approached from the perspective of accounts being reportable or non reportable and, within a reportable account, there might be assets for which reporting is not required. Changing to an approach in which the account and the asset must be considered differently can result in substantial programming effort and increased processing times since large portions of the account population must now be considered separately by the process.

1.4.2. Reviewing the account population

In addition, the specific types of entities that are no longer exempt may not coincide with the account classifications that are maintained by many firms. In that case, not only would new classifications be needed, the existing account population would have to be surveyed. This is an exceptional undertaking and would require an extended period of penalty relief. All other programs that interact with the account classifications (whether for purposes of information reporting or not) would also have to revised.

1.5. Issuer information return obligations 4.02

- Form 8038 / 8038-TC
- Inclusion of all possible CUSIP numbers
- Strippable declaration

1.5.1. Collecting and publishing sufficient information

Will the issuers be required to include their EINs or SSNs as part of the 8038-TC filing? And, if so, will that preclude publication of the information? This is a crucial issue because there is a gap between what the issuer makes public in its official offering documents and what a broker is required to report to the beneficial owner and to the Service on form 1097-BTC. The EIN is one of these elements. All the static information required for the 1097-BTC should be collected via the 8038-TC and published by the IRS expeditiously. If the EIN (or other data element) can not be published, it should not be required for the 1097-BTC.

1.5.2. How are repackagers of the tax credits treated?

When the stripped credit allowances are bundled into a structured product, will the issuer of the structured product be required to file a Form 8038-TC as well? If so, would it supply its own EIN or that of the originator of the tax credit? Consider what might happen if the structured product was an aggregation of tax credits from several different tax credit bonds. The structured product would have a single CUSIP number, but it would convey entitlement to tax credits that are associated with many different issuers' CUSIP numbers and EINs. If the issuer was a foreign entity, lacking an EIN, an additional level of complexity would be added to this picture. Further, industry announcements of entitlement to distributions (and now tax credits) exist only with the CUSIP number that corresponds to the asset held by an account, not the assets that underlie that issue. It must be done in this manner to ensure that the benefit is conveyed to the investor that is entitled to it. The same would also be true of pass through entities such as RICs which characterize their distributions for tax purposes but can not attribute those amounts directly back to individual assets held in their portfolios.

1.6. Taxpayer reporting obligation 4.03

- Include Form 8912 with tax return
- Form 8912 expected to be modified to include information beyond its current requirements
- There is one form per CUSIP number
- Tax credit amounts
- Types of tax credit bonds
- Issuers' EINs
- CUSIP numbers of the credits being claimed

1.6.1. Reporting the issuer's EIN

Taxpayer is supposed to get the issuer's EIN from the Form 1097-BTC. As stated in section 1.7.1, it is unclear that this information will be available to the form filer and the information is not of any apparent use to the beneficial owner. If the answer is that the taxpayer needs it to complete form 8912, the process would only have accomplished passing the information in a circle (since the service has this information from the issuer's filing of Form 8038-TC).

1.6.2. Other data elements

If the Service has received all the information regarding the bond (issuer's EIN, type of tax credit bond, etc) on the issuer's filing (8038-TC), why would the taxpayer have to indicate anything beyond the CUSIP number and bond type if it's a new Clean Renewable Energy Bond (CREB)? These additional pieces of information are attributes of the security that are uniquely identified by the CUSIP number.

1.6.3. The future Form 8912

The current version of 8912 functions as a worksheet with which the taxpayer computes the amount of tax credit. Will the changes to this form simply accommodate inclusion of the credit allowance amounts as reported to the taxpayer on Form 1097-BTC with adjustments for new CREBs?

1.7. New Form 1097-BTC to report tax credit allowance to beneficial owners 4.04

- Required of issuers and independent intermediaries
- Report annually for 2010, quarterly thereafter to the tax credit beneficiary
- Tax credit allowance amount separately for each allowance date
- CUSIP number
- Issuer's EIN
- Indication of whether the form generator is an agent of the issuer or an independent intermediary (and/or recipient of form 1097-BTC)
- Draft form also requires "Stated principal," "Bond issue date," "Maturity date" and "Code,"

1.7.1. Availability of issuer's EIN and other data

Where and how will the filer of Form 1097-BTC obtain the issuer's EIN? A filer can not reasonably rely upon learning this information via a chain of reporting from issuer to beneficiary. The requirements of the 8038-TC filed by the issuer, the 1097-BTC filed by the independent intermediary and the 8912 filed by the taxpayer must be harmonized and simplified.

1.7.2. Reporting frequency

What is the benefit of quarterly reporting to the taxpayer? The corresponding interest and OID income are reported annually. If the credit allowance is reported quarterly, is it expected that these same amounts are also reportable annually? Many data processing routines, whether in-house or via a service provider are organized around annual reporting, filing and correction cycles. This is particularly true of events, such as tax credits which aren't captured in the normal course of business as cash transactions and are logically segregated for information reporting. In most instances, transactions such as tax credits are identified at the conclusion of the year as part of a single process to identify and report all non cash items.

1.7.3. Composite statements

Will filers be permitted to include the 1097-BTC as part of a consolidated year end statement with forms 1099?

1.7.4. What's the ultimate data model?

With this new form, the Service is moving to a model that increases both the frequency and granularity of the required reporting, going from annual to quarterly and from aggregate to transaction level[2]. It seems highly probable that the reporting obligation might be met with modifications to existing forms and with the annual reporting frequency. With more insight into how the Service intends to use the information in matching programs and reconciliation we can potentially offer more efficient solutions.

1.7.5. Potential confusion to holders of RICs investing in tax credit bonds

If the tax credit is passed through from a RIC, securities processing systems would generally associate the credit with the CUSIP number of the asset that the investor owned (in this case the RIC). Remember that this is also the asset with which the income relating to the tax credit will be associated. Reporting the tax credit as associated with an investment that the taxpayer does not own (the tax credit bond) will lead to confusion. Take the example of an investor who, through a brokerage account, owns shares in a mutual fund that has a tax credit bond in its portfolio. Under the reporting envisioned, the investor would get a quarterly 1097-BTC from the brokerage firm showing a tax credit associated with the tax credit bond. The investor would have no knowledge of owning this bond. Further, when receiving annual 1099s from the broker, the investor's income from the fund would exceed the cash distributions received by the amount of the tax credit, but would be associated with the fund's CUSIP and description.

Implicit in this process is also an expectation that the nominee would know from receipt of the RIC's 1097-BTC which specific bond/strip is producing the tax credit. Is this the case? This type of reliance on a chain of reporting is simply not reliable.

1.7.6. Exempt recipients

Are any entities exempt for purposes of 1097-BTC reporting?

1.8. Reporting interest and OID income attributable to tax credit allowances 4.05

- Report the tax credit allowance as interest (from a bond) or OID (from a strip)
- Report accrual of OID on stripped component
- Report tax credit as dividends if passed through to RIC/REIT owners.

1.8.1. Characterizing the stripped tax credit on the "maturity" date

Ordinarily, the maturity of a stripped interest payment is reported on a 1099-B. By implication, the allowance of a tax credit on the maturity date of a stripped tax credit would also be reported on 1099-B (not 1099-INT) since, as a payment of non qualified stated interest, income would have been accrued on 1099-OID. The tax credit should not be reported as income on 1099-INT but should be reported as a tax credit on Form 1097-BTC. Is this the expected treatment?

1.8.2. How should the nominee compute OID in the absence of purchase price?

A. When a stripped tax credit is purchased, its issue price is the purchase price paid and the issue date is the purchase date. OID is computed accordingly. If the position is subsequently transferred to another broker, the adjusted basis will not necessarily be transferred, as the cost basis regulations addressing fixed income are not written and would not be applicable to purchases made before 2013. If the strip was an interest payment from a treasury obligation, Publication 1212 could be used for a daily rate of accrual. What would be the equivalent in this scenario?

B. If the holder of a tax credit bond decides to strip the bond of its credits, the pieces that remain would be held under the unique CUSIP numbers assigned to the various tax credit allowances and interest payments as illustrated in section 1.3.1 above. In the absence of a resource such as publication 1212, the broker that holds the strips as nominee would not have sufficient information to compute the OID unless the investor, upon completion of the stripping transaction, provided an allocation of its basis in the original bond across the strip components. Establishing those values is not within the competency or responsibility of the broker. Neither would there be published quotation of market values on which to rely. If the taxpayer will not be required to provide such information, there needs to be an equivalent to the Publication 1212 STRIP table on which nominees can rely for information reporting or there needs to be penalty relief for lack of reporting. A table based on tax credit dates, similar to the existing maturity-date-based table in Publication 1212 would work for this requirement.

1.9. Endnotes

[1] The following is excerpted from the official statement for *Baltimore County Consolidated Pubic Improvement Bonds – 2009 Series D Qualified School Construction Bonds* and is representative of other similar issues.

> "Separation of Principal Component and Tax Credit Component. The Executive Order provides that, to the extent permitted under the Code and applicable law, at any time, by written request to the Paying Agent in the form attached thereto (the "Tax Credit Strip Request"), the Owner of a Tax Credit Bond may, upon presentation to the Paying Agent of such Tax Credit Bond, direct the Paying Agent to authenticate and deliver (i) a Principal Strip Certificate in a principal amount equal to the principal amount of the Tax Credit Bonds to be so separated and (ii) Tax Credit Certificates representing the allocable Tax Credits with respect to such Tax Credit Bonds. The form of the Tax Credit Strip Request may be modified or amended by the Paying Agent with the prior written consent of the County. Upon the receipt of a request and the presentation of the Tax Credit Bond to be stripped, the Paying Agent is required under the Executive Order to: (i) authenticate and deliver to or upon the order of the Owner so requesting, a Principal Strip Certificate in a principal amount equal to the principal amount of the Tax Credit Bond so presented; (ii) authenticate and deliver to or upon the order of the Owner so requesting, Tax Credit
>
> Certificates for each remaining Tax Credit Allowance Date in a face amount equal to 25% of the product of (A) the principal amount of the Tax Credit Bond so presented and (B) the Tax Credit Rate; and (iii) contemporaneously with the delivery thereof, reduce, by the amount so converted the amount of Tax Credit Bonds that have not been stripped.
>
> The Executive Order provides that, notwithstanding the separation, if any, of the ownership of the Principal Component of a Tax Credit Bond from the related Tax Credit Component, the previously combined Tax Credit Bond will remain outstanding and the ownership of Principal Strip Certificates and the Tax Credit Certificates shall constitute such outstanding Tax Credit Bond."

[2] Currently, 1099-B is at the transaction level but recent developments in the WHFIT reporting regulation and proposed Cost Basis regulations indicate more movement toward aggregation. The 1099-OID is reported at the CUSIP level, but the income is aggregated for the year, not broken down to accrual periods.

Appendix I
Additional Comments on Notice 2010-28 and Form 1097-BTC (July 26, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

July 26, 2010

Mr. Timothy Jones
Office of Associate Chief Counsel (Financial Institutions and Products)
Re: Notice 2010-28
CC:FIP:B5, Room 3547
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Notice 2010-28-Additional Comments; Stripped Tax Credits and Form 1097-BTC

Dear Mr. Jones:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to provide additional comments on Notice 2010-28[2]. This Notice describes regulations that the Treasury Department and the Internal Revenue Service (IRS) expect to issue concerning both stripping transactions for qualified tax credit bonds under section 54A of the Internal Revenue Code and certain income tax accounting matters associated with holding and stripping these bonds. In addition, this Notice describes anticipated related information reporting requirements.

IRPACs comments include discussion and recommendations related to (1) OID computation on stripped tax credits where the purchase cost is unavailable, (2) treatment of stripped components as an aggregated instrument and (3) reporting tax credits on Form 1097-BTC.

STRIPPED TAX CREDITS

Computing Original Issue Discount where Purchase Cost is Unavailable

Original Issue Discount (OID) must be computed and reported for stripped tax credits. This computation requires three elements: the maturity date, the issue price and the issue date. Although a specific tax credit has a maturity date equivalent (allowance date) and a unique CUSIP identifier, there is no distinct issue price or issue date associated with that CUSIP number as there would be for a bond (whether interest bearing or zero coupon). For strips the original issue price is the holder's purchase

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

[2] See IRPAC's previous comments dated May 21, 2010.

price and the issue date is the holder's purchase date. Even in the context of traditional bond stripping, this information is not always available such as when securities are transferred to other brokers, or where they are acquired in a bulk acquisition through a delivery versus payment (DVP) account where custody for the beneficial owner is held elsewhere. In the context of stripping tax credits, secondary trading may be even more complex, such as when acquired in some form of collective ownership, such as through a trust or partnership and then distributed for use (apart from in a mutual fund context).

This circumstance will arise repeatedly on security positions transferred in the period before 2013 when fixed income instruments become "covered securities" in the context of the cost basis reporting requirements of section 403 of the Energy Improvement and Extension Act of 2008, Division B of Public Law 110-343. As a result, a method of computing the OID must be available when the custodian of the position having information reporting responsibility is not aware of the purchase price and purchase date for a given position.

The Treasury STRIP Model

The most prominent model for meeting this type of reporting requirement is the computation of OID for Stripped Components of U.S. Treasury and Government-Sponsored Enterprises. For holdings of these instruments, brokers and other middlemen may rely on section II of IRS Publication 1212[3]. This table provides a substitute amount that brokers and other middlemen use to accrue an approximation the OID income. Brokers are permitted, but not required, to compute the OID income specific to a holding and, if the purchase price and purchase date are not available they would then look to Publication 1212 to fulfill the reporting responsibility. Approximately 57% of the outstanding holdings[4] in currently in custody have the tax-lot-specific information required for this calculation, with the balance relying on the amounts published in Publication 1212.[5]

Cost basis reporting mandated for acquisitions after 2012 will, over time, increase the percentage of positions receiving the OID computation specific to the holder's purchase information, but will do nothing to enable brokers and other middlemen to meet the reporting requirement for strips purchased before that time. Moreover, not every relationship is considered under the cost basis requirements that will enable purchase price information sharing. There will be gaps.

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[3]The 2009 version of the Publication 1212 tables are found at http://www.irs.gov/pub/irs-utl/2009p1212_sect_i-iii_2nd.pdf. Section II is displayed on pages 86 and 87.

[4] The statistic is based on a sampling of firms whose data is processed by Wall Street Concepts, a business unit of SunGard Brokerage and Clearance.

[5] Additionally, Publication 1212 provides information for reporting OID income for maturing Treasury Bills and other short term discount obligations. This is another situation in which the custodian may not be in possession of the purchase cost, but is able to rely on the publication to fulfill information reporting obligations.

Recommendation

Section II of IRS Publication 1212 lists ranges of maturity dates and for each establishes the OID income per $1000 to report for an entire year. IRPAC recommends that the publication's structure be modified to accommodate an additional column for annual income on stripped tax credit allowances. The column currently titled "OID per $1000" would be renamed to distinguish it as applicable only to federal strips while the newly added column should be distinctly labeled as applicable to tax credit strips.

Alternately, the Service could publish annually a factor that allowed the amounts from Section II of Publication 1212 to be adjusted for use with stripped tax credits. This approach could also be extended to provide a factor for the interest payments stripped from tax credit bonds and tax credit bond corpuses. For a strip held an entire year the calculation would take the following form:
[Face amount/1000] * [Publication 1212 Amount] * [TC adjustment factor]

With Section II of Publication 1212 limited to 2 pages, we believe these approaches are worthy of consideration as practical and cost effective, particularly in consideration of the fact that cost basis regulations will eventually greatly limit the instances in which the purchase date and purchase price are unavailable. Further, the number of outstanding tax credit bonds for which strippable tax credits are available is limited by specific legislative authorizations. Also consider that within the Build America Bond population a great majority of issuers seem to be opting for the subsidy payments rather than issuing bonds with tax credits[6].

It is important to note that even though the gap will diminish, it will not be fully closed and purchase information will still be missing in some cases. There will need to be some rule for brokers as to what to do if such information is missing or considered unreliable. IRPAC suggests the better process is one of the methods suggested above. Brokers cannot be held accountable for data beyond their ability to acquire it.

<u>Treating stripped components as an aggregated instrument</u>

Notice 2010-28 foresees a broker treating a group of stripped components held in the same account that are derived from a common bond as a single aggregated instrument for the purpose of computing OID income. For a variety of reasons explained above and further below, this approach would be extremely difficult to implement as brokers will not always have access to the aggregated information nor will they have the systems architecture, industry infrastructure and reference data necessary to comply.

[6] The SIFMA 2010 Municipal Issuance Survey indicates that only $5 billion of a projected $110 of taxable municipal bonds to be issued in 2010 will be tax credit bonds.
http://www.sifma.org/uploadedFiles/Research/ResearchReports/2009/Municipal_MunicipalIssuanceSurvey2010_20091207_SIFMA.pdf

Required information and available processes

The operations of financial services firms rely on a “Security Master” file which is a repository of descriptive information for stocks bonds and other financial instruments. The primary identifier used in these files is the CUSIP number. Descriptive information and features (issue date, maturity date, security type and classification) are stored to ensure proper treatment of the asset for various processes (transfer, valuation, income characterization, timing of payments, information reporting, etc.). Firms do not, however, have the necessary information or processes required to discern that various CUSIP numbers have a common parentage that would facilitate aggregation of the disparate stripped components as a single instrument[7]. Without having determined and stored this information, clearly, processes would need to be built to continuously review investor portfolios to determine if the assets held can or should be considered in aggregate. This process may even need to spread over many different accounts and between different financial institutions, presenting impossible tasks that even the cost basis provisions will not address.

If a collection of assets could be considered in aggregate, the custodian would then have to assign a unique identifier (not an industry recognized CUSIP number) and construct an OID rate schedule to supplement the publicly available amounts published in Publication 1212 in order to make this holding part of its information reporting processes[8]. If the aggregated position were transferred to another institution, the unique security number being used would not be recognizable to the receiving party. The transfer would be facilitated as movement of all the stripped components (identified by their standard CUSIP numbers) via the existing automated account transfer structure (ACATS) with book entry security movements at the industry’s depositary, the Depository Trust Company (DTC). There are no universal rules for a firm's maintenance of security numbers apart from the CUSIP process.

Reconciliation with the depository

On a nightly basis, financial service firms reconcile their account positions both internally and externally. In the external reconciliation, firms are ensuring that they are in agreement with the various depositories at which their positions are held for settlement. This process relies on securities having identifiers that are recognized throughout the industry. As described above, for a firm to compute and report OID on an aggregation of stripped assets would require the creation of an identifier unique to the aggregation. The unique identifier would have to be tracked in some sort of shadow account while the actual books and records of the firm continued to

[7] A CUSIP number’s first 6 digits denote the identity of the issuer, but not the specific bond issue, so the structure of the number is not sufficient to reliably detect the existence of a potential aggregation. Also, for active issuers, the six digit prefix does change periodically.

[8] Each credit would be treated as non qualified stated interest payment, a yield would be calculated and a lifetime OID accrual schedule (associated with the unique identifier) would be created. A 12 month slice of the schedule, in the format of Publication 1212 entries, would be used in the process for each calendar year.

reflect the individual stripped components according to their CUSIP identifiers[9]. To do otherwise would cause perpetual mismatches with the depository (DTC breaks, in industry parlance).

With this shadow infrastructure not in existence anywhere, it is doubtful that aggregated reporting would ever become a reality, particularly in light of the limited number of instruments outstanding.

Integration with existing processes

The reportable OID income for an aggregated instrument would have to be merged into standard data streams for information reporting and systems would also have to be modified to ensure that no reportable amounts were computed for the strips individually (when an aggregation exists) as this would lead to double reporting. This is important, not just from the perspective of avoiding overreporting; if there is a single strip in an account, computation of its OID would have to be done according to its standard CUSIP identifier and must not be overlooked because an aggregation was anticipated.

Sales and transfers will create countless variations and combinations

If an aggregation was discernable and identifiable, there is nothing that would require the investor to retain the distinct aggregation for any length of time. For example, the owner of a bond with a term of ten years could strip the bond into its 41 components (corpus and 40 tax credits). Once stripped, they will independently trade in the secondary market, allowing the investor to immediately sell any number of the strips (in varying quantities). The remaining unsold pieces form a new aggregated instrument for which a cost basis must be established and OID accrual must proceed from that date forward (based on a newly constructed custom OID accrual rate schedule). The investor is free, at any time and with any frequency, to sell additional pieces and, in effect, create new aggregations that would require unique identifiers, computations of basis and a new OID accrual schedules. As a result, the number of unique aggregated instruments that an account could theoretically hold over time would be nearly infinite. Each sale transaction would also require allocation of a portion of the basis of the aggregated instrument to the piece sold for the 1099-B (as required beginning in 2013). Further, the investor would be able to reacquire any of the previously sold stripped tax credits through the secondary market, again creating a new aggregation.

It is important to note that anywhere in this process an aggregation, in whole or in part, can be transferred to another institution. Whether brokers offer a stripping process or not, most brokers will be forced to support the transfer of the composites.

[9] It is worth noting that Notice 2010-28 03(c)(3) and (4) detail the requirements for tax credit issues to be held in book entry form and to have CUSIP numbers assigned for each strippable component. This suggests that there is a desire to have the reported income and tax credits associated with an identifier known, not only to the industry, but to the IRS as well. Aggregating under a single user-defined ID seems contrary to this intent.

If aggregation is not required, each stripped component becomes a unique instrument, identified by an industry recognized CUSIP number that was established by the bond's issuer at the time of the original offering. Although a casual observer might conclude that it is easier to track a single aggregated instrument, that instrument is an exception in every aspect of standard processing and is subject to infinite variations that would require substantial computation for each iteration imaginable.

In conflict with cost basis reporting requirements

If a collection of strips is considered in aggregate for the purpose of OID accrual but individually with regards to cost basis requirements (transfer statements and Forms 1099-B), we are dealing with multiple reporting requirements for a single asset. The accrual of OID is integral to the maintenance of an adjusted cost basis.

In the aggregation scenario, the custodian would establish a unique identifier to track the collection of strips and would have an associated cost basis for the aggregation. If the account were transferred to another financial service firm, the movement of securities through standard industry facilities would reflect the individual stripped components for which individual bases do not exist under the aggregation. Similarly, the sale of a single strip component from the aggregation will eventually require, under the cost basis regulations, that a basis be reported on the 1099-B although none had been established or tracked. Again, the movement of all the components might seem daunting because of the number of securities, but the transfer would actually be handled without incident, and, if no aggregation had been done, would far more readily include an adjusted basis.

Stripping as a transaction unique from the sale or transfer of a stripped component

As the tax credit bond market currently operates, the registrar (or other representative of the issuer) facilitates stripping transactions by accepting the bond and returning the various remaining tax credits (and/or interest payments and bond corpus) to the submitting institution[10]. There is no facility for an owner of the bond to selectively sell or transfer an individual tax credit, interest payment or bond corpus without first having the bond stripped into its component pieces. It is at this point in time that basis can be allocated to all the pieces[11]. Although this may seem more tedious than the aggregated approach, it ensures that the infinite revaluations and reassignments of basis that are possible with aggregation do not take place. This facilitates the accrual of OID routinely on each component, and, in turn, the transfer of these assets with adjusted cost basis.

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[10] This process was described in greater detail in IRPAC's comment letter dated May 21, 2010.

[11] When publishing regulations regarding the handling of fixed income instruments for cost basis reporting, the IRS would be able to provide guidance regarding the method of allocating basis from the original bond to its components. This would ensure a consistent approach to determining the issue price of the strips for purposes of OID computation. There is an implication here that the issuer's agent would be responsible for allocating the basis received on the transfer statement for the bond. This must be clarified in future regulations.

Further, it will allow the product to trade in the secondary market which is a critical component of keeping the product liquid and assuring a market exists to support any sales including initial offerings since the reception, even in initial offering in the market, will rely on ability to later sell if necessary. Aggregation will encumber this process.

This segregation of stripping from the sale of stripped components is not unique. The best model, again, is found in the Treasury market where the ability of an investor to strip a bond is available only via a financial institution. It is explained as follows on the TreasuryDirect website: "STRIPS are not issued or sold directly to investors. STRIPS can be purchased and held only through financial institutions and government securities brokers and dealers."[12]

Recommendation

For investors holding disparate stripped bond components (with common ancestry) in an account, IRPAC recommends that brokers be required to report the accrual of OID income to investors specific to each separate strip. Additionally, brokers should be permitted to report to their investors using an aggregated approach as an alternative. Maintaining the strips as unique assets has numerous benefits:

- The need to track shadow positions for aggregations while keeping the firm's books and records synchronous with the depositories is eliminated;
- The income, tax credits and sales proceeds associated with a particular strip would be reported under the same CUSIP number, providing greater simplicity for the investor and greater audit capability for the IRS;
- By employing existing system architecture, the cost of implementation is minimized while its speed is maximized;
- By reporting OID on each stripped component rather than an aggregation, the relationship between OID reporting and cost basis is maintained;
- With the maintenance of basis simplified, the ability to transfer positions from one firm to another with adjusted cost basis or include basis on the 1099-B when a component is sold is maximized; and
- If the initial basis in a bond is allocated among the various stripped tax credits, interest payments and bond corpus only when stripping takes place, a potentially unending number of customized calculations for OID and basis allocation is eliminated.

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[12] Additionally, the Commercial Book Entry System is operated by the Federal Reserve Banks as fiscal agent of the Treasury. See, http://www.treasurydirect.gov/instit/auctfund/held/cbes/cbes.htm

REPORTING TAX CREDITS ON FORM 1097-BTC

New form and reporting requirement

Form 1097-BTC is a new form requiring annual reporting to the IRS and quarterly reporting to beneficial owners of tax credits. Besides the 1097-BTC being an entirely new form, the fact that it requires reporting with greater than annual frequency and that it covers non-cash events make implementation for 2010 (when only annual reporting is required) a huge challenge. Also, since many firm's production of information returns involves substitute statements, the lack of guidance in this regard is an additional impediment.

Recommendations

To ensure a smooth and accurate implementation of this reporting requirement, IRPAC offers the following suggestions:

Consider whether an additional form is necessary

Since the beneficiary of the tax credit allowance will receive a 1099-INT or 1099-OID reflecting the income recognition related to the tax credit, it would seem that an additional box on each of those forms might be sufficient for the annual reporting. With CUSIP level reporting already under consideration for the tax exempt issues reported on a Form 1099-INT and 1099-OID already a CUSIP specific form, this might be a good fit. It would also provide the investor with a more concise view of all the implications of the investment.

Allow flexible means of notification for quarterly requirement

With information reporting systems essentially geared to annual production, the addition of a quarterly requirement is challenging, particularly for noncash activity that is not captured by such systems (nor a monthly statement systems, for that matter). IRPAC recommends that the IRS adopt a flexible approach to allowing firms to notify beneficial owners of their allowance. This would included individual notices (electronic notification permitted), inclusion in monthly statements, etc.

Allow as part of a consolidated payee statement

If a distinct 1097-BTC is deemed to be required, IRPAC recommends that it be permitted as part of a consolidated payee statement along with Forms 1099-DIV/INT/OID/B.

Delay the requirement to allow for development

Regardless of which course is taken, it is too late in the year to design, test and implement this reporting, particularly considering the lack of an official form and guidance regarding substitute statements. IRPAC recommends that the annual reporting requirement be moved back to 2011 and the quarterly to 2012 (or later if the required guidance is not forthcoming during 2010).

Thank you for the opportunity to provide these additional comments on Notice 2010-28. We are available at your convenience to discuss these comments with you and your staff. If you have any questions, please contact the undersigned.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

Appendix J
IRPAC Comments on Notice 2010-43: Recommendation for 2010 2011 Guidance Priority List (June 11, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

June 11, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Recommendation for 2010-2011 Guidance Priority List – Notice 2010-43

To Whom It May Concern:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to recommend items that should be included on the 2010-2011 Guidance Priority List. We request that the Internal Revenue Service (IRS) update its guidance on last known addresses specifically related to business addresses.

IRS Revenue Procedure 2010-16 provides an explanation of how IRS is informed of a change of address. The address of record is crucial as it is the address used for all correspondence including but not limited to notices and refunds of overpayment of taxes.

Many businesses have multiple locations with various functions, e.g. payroll, income tax, information reporting etc, that file returns and receive correspondence from the IRS. Under the current system and processes, the address of record changes each time a return is filed by any of those functions. The end result is notices and correspondence are misdirected within each of those affected companies. That results in errors anywhere from unresolved B-notices to misdirected refunds.

The following are some of examples where this has proved problematic:

- A large bank's payroll tax department received B-Notices for the bank's Form 1099 processing unit
- An outsourced payroll service received notices for a firm's corporate tax obligation

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

- A bank's customer, who mistakenly used the bank's address and EIN on a nominee Form 1099, received the banks IRS correspondence

Background

The IRS Business Master File is the repository for Name and Address information for all of the registered business entities within the United States. The current technology employed by IRS only allows one entry for each registered business. Rev. Proc. 2001-18 outlined the IRS process and recently released Rev. Proc 2010-16 provides updated guidance including procedures for electronic and oral address changes. Both revenue procedures apply to individuals as well as businesses and provide the same treatment for both. An increasing number of businesses have decentralized processes causing a greater number of cases of misdirected communication. Historically, when more businesses operated out of one address, the consistent process between individuals and businesses was acceptable. However, through acquisitions and decentralization, this model no longer works.

Recommendations

- IRS should immediately update Revenue Procedure 2010-16 to separate last known address processes between businesses and individuals. For example: current procedure requires that the entity disclose the old address in order to make a change. However, since many businesses have multiple locations the business has no way of knowing which address is on the Business Master File (BMF) record.
- IRS should allow for an indicator on each company's BMF record. That indicator would lock the contact and address information unless an authorized change is made using Form 8822
- Alternatively, IRS should pursue an option where each business form includes a check box that can be used by businesses to indicate that the address should be changed.
- In the event IRS is not able to accommodate the previous recommendations, IRS should consider allowing businesses to opt out of the current procedure of automatic address change with each tax filing. In this case, the business would be required to file Form 8822 to change their business address.
- IRS should accelerate the development of a system that allows for multiple addresses and contacts. The system should also include the ability to directly associate that information with specific IRS functions.

Thank you for your attention to this matter. We look forward to working with IRS to resolve this issue. If you have any questions, please contact the undersigned.

Sincerely,

Lisa M. Chavez

Lisa Maria Chavez
2010 IRPAC Chair

Appendix K
IRPAC Comments on IRC § 6050W Proposed Regulations (January 20, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

January 20, 2010

Hon Douglas Shulman
Commissioner of Internal Revenue
CC:PA:LPD:PR (REG-139255-08)
Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: REG-139255-08

Dear Commissioner Shulman:

The IRS Information Reporting Program Advisory Committee (IRPAC) is pleased to submit for your consideration the following comments on proposed regulations (REG-139255-08) issued November 24, 2009[1], under Internal Revenue Code section 6050W which was added to the Code by section 3091(a) of the Housing Assistance Tax Act of 2008[2]. Our comments principally address the definition of "gross amount" and related issues regarding timing and backup withholding. We also provide suggestions regarding Form 1099-K, duplication of reporting, electronic payee statements, additional examples to be included in the regulations, foreign-related issues, and the de minimis rule provided to third party networks. Each of these items is discussed in turn below.

IRPAC was established in 1991 as a result of an administrative recommendation contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the Internal Revenue Service (IRS) consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system."

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[1] Fed. Reg. Vol 74, No. 225, pgs 61294-61306, Nov. 24, 2009
[2] P.L. 110-289, 122 Stat. 2654. Hereafter, all section references are to the Internal Revenue Code or Treasury Regulations.

Gross Amount – What to Report

Section 6050W requires each payment settlement entity (PSE) to make a return setting forth, among other things, the "gross amount" of the reportable payment transactions with respect to each participating payee. In Notice 2009-19, "Information Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions"[3], the IRS and Treasury requested public comments regarding guidance under section 6050W, including whether the "gross amount" of the reportable payment transaction should be defined as "gross receipts or sales" or whether adjustments should be made for credits, cash equivalents, discounts, fees, refunds, or other amounts. The IRS and Treasury decided against making the latter adjustments in formulating the definition of "gross amount" in the proposed regulations. Specifically, the regulations provide the following definition of "gross amount":

> …gross amount means the total dollar amount of aggregate payment transactions for each participating payee without regard to any adjustments for credits, cash equivalents, discount fees, refunded amounts or any other amount.

Based on a literal interpretation of this definition, it appears that payment settlement entities will be required to report only positive sales transactions, without even adjusting for negative sales transactions such as the return of merchandise. The following example illustrates this interpretation.

On day 1, merchant A conducts the following payment card transactions:

T-1 $100 sale
T-2 $100 sale
T-3 $100 sale
T-4 $100 sale
T-5 $50 returned merchandise

On day 2, the PSE receives funds from the system to pay the merchant and initiates an electronic deposit to the merchant's bank account under standing instructions. The merchant has access to the funds on day 3.

In this example, it would appear that the "gross amount" required to be reported under the proposed regulations is $400, which reflects gross positive transactions not adjusted for anything including returned merchandise. This interpretation has caused significant confusion in the acquirer community.

While this number is a number that generally the industry can report, it should be pointed out that adopting this approach would lead to other issues:

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[3] Notice 2009-19, 2009-10 IRB 660 (March 9, 2009).

1. What is the date of the transaction for reporting purposes? Under normal "paid or credited" rules of the Code, money is deemed paid when funds are made available to the recipient without significant restriction. If the payment were by check, the date the funds would be deemed paid for reporting purposes would be the date the check were mailed (though a cash-basis taxpayer would not take the funds into income until received.) Using that approach, the appropriate date of reporting is the date the PSE/EPF electronically initiates the deposit of the funds to the merchant (Day 2). However, if the date required by the regulations is the actual date of the transaction, a number of issues arise:

a. If backup withholding is required, there are no funds on the date of the transaction from which backup withholding could be satisfied.

b. If a transaction is rejected from processing it may be resubmitted another day. Would this transaction be included the first time it is submitted (and rejected), or the subsequent time it is submitted and accepted? If it is never re-submitted, is it ever included in the totals reported?

2. Additional backup withholding issues also would arise from adopting this approach.

a. if backup withholding is required, the base on which the nominal rate of 28% would be applied would be artificially inflated leading to a much higher effective rate. If the amount to report were gross positive transactions ($400 in the above example), the amount of backup withholding would be greatly overstated and would result in an effective withholding rate much greater than the stated rate in the statute, currently 28 percent. In that example, if backup withholding were required to be imposed on $400 instead of the $343[4] actually paid to the merchant, the withholding rate would be 32.6 percent. If one of the transactions were rejected so that the actual payment to the merchant were only $245[5][6], the effective backup withholding rate would be 45.7 percent of the amount actually paid[7]. In addition, imposing backup withholding on gross positive transactions also will lead to the undesirable result that any backup withholding done for a transaction later reversed by refunding the returned merchandise's full purchase price will not be able to be recovered by the merchant until a tax return is filed, potentially severely disrupting the merchant's cash flow.

[4] Assuming a 2% fee is charged on the $350 actually available to pay the merchant.
[5] $400 - $50 (returned) - $100 (rejected) = $250 less a 2% fee = $245
[6] $400 x .28 = 112 which is 32.65 percent of $343.
[7] $400 x .28 = 112 which is 45.7 percent of $245.

b. If transactions are reportable as of the transaction date, but backup withholding is not required until the funds are available, some transactions in year one will not have backup withholding imposed until year two creating a need to supply special rules for reporting and depositing these “crossover transactions”.

3. Some EPFs do not know the transaction totals, just the payment amounts. In such a situation, the EPF receives a list of who to pay and how much, and, of course, the date the payment should occur. Here the EPF does not know anything about the amount of gross positive transactions, the net transactions, or any other amount other than the amount it is told to pay. There is no mechanism for such transaction information to be shared with the EPF. As a result the only number the EPF could report is the amount paid yet this would not conform to what the regulations require.

It is IRPAC’s belief that the best, most useful and most easily identified number to report to the IRS is the amount actually paid to the merchant. In the above example, that number would be $350[8] less the fee charged to the merchant for conducting the transaction. If the fee were, e.g., two percent, the amount made available to the merchant would be $343. This is the best number to report as it reflects the amount “paid or credited” to the merchant’s account and is an amount that is known to both PSEs and EPFs.

It is the gross amount paid to the merchant not adjusted for other items such as cashback which the merchant, but not necessarily the PSE/EPF, knows and can adjust for on his tax return. In other words, the word “gross” in the statute refers to the amount of the payment to the merchant not adjusted for other items, like cashback, to arrive at actual taxable income. The regulations should reflect that usage.

By defining the reportable amount as the amount paid to the merchant rather than gross positive sales transactions, and the time for reporting as when it is paid to the merchant rather than the date of the transaction, the issues outlined above are resolved. Both the amount and date for reporting are clear, and the backup withholding problems regarding date of withholding, lack of available funds, and over-withholding do not materialize.

IRPAC recommends that IRS adopt the following definitions:

Gross amount means the amount paid to the merchant. Monthly amount[9] means the gross amounts paid to the merchant during a calendar month. Annual amount[10] means the sum of the twelve calendar monthly amounts. For

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[8] $400 sales - $50 returns if there is no rejected transaction.
[9] Boxes 5a through 5i on draft Form 1099-K.
[10] Box 1 on draft Form 1099-K

these purposes, "paid" means a payment initiated by the PSE/EPF as an electronic deposit to the merchant's account in accordance with standing instructions agreed to between the PSE/EPF and the merchant. Any amount diverted to another repository or recipient, such as a payment to the merchant's reserve[11] account at the PSE/EPF, is considered paid to the merchant when so diverted.

Because clarifying the definition this way will have an impact on systems development by PSEs, IRPAC also urges IRS to announce their final definition of gross amounts as soon as possible to provide the maximum time possible to implement the requirements.

Form 1099-K

IRPAC applauds IRS's decision to create a new form for reporting under IRC section 6050W. The likely alternative, Form 1099-MISC, is already too crowded. In addition, using the same form for reporting under sections 6041 and 6041A on the one hand, and section 6050W on the other, would have been confusing not only for taxpayers, but also for filers, and for the IRS itself. Using separate forms for the distinct reporting obligations will greatly assist all parties in understanding what is reported and how it is related to properly preparing tax returns.

The draft 2011 Form 1099-K released, and for which IRS solicited comments, included only the face of the return and neither the instructions for the recipients nor the separate instructions for the filer. IRPAC feels that both are critical to the proper filing and use of the form and would be happy to work with IRS on appropriate verbiage for both. For the instructions for the recipient, it is imperative that IRS inform them that the numbers reported may not correspond to the monthly statements provided for business purposes and that for tax purposes they should use their own books and records. In addition, any inquiries about the form should be addressed to their own tax advisors. For the instructions for PSEs and EPFs, IRS must properly describe the appropriate roles for each, and describe the mechanics of backup withholding and the timing of the reportable event. By adopting the suggestions above with regard to gross amount, the appropriate roles and mechanics will be easier to identify and explain.

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[11] Merchants generally are required to maintain a reserve account that is an escrow account providing a cushion for the PSE/EPF in case of negative payments to the merchant or in case of inappropriate activity by the merchant. From time to time the merchant may be asked to increase the reserve, and that increase may be accomplished by directing a regular payment to the reserve account instead of to the merchant's regular depository account. Such infrequent actions would be deemed paid to the merchant as of the time they are paid to another account at the direction of the merchant either directly or as a part of the standing instructions negotiated as part of the acquiring enrollment process.

Duplication of Reporting

IRPAC applauds the IRS decision to eliminate duplication between sections 6041/6041A and section 6050W. This decision will serve not only to reduce burden on filers, but also to minimize confusion on the part of taxpayers who would have seen credit card transactions reported twice, business check transactions reported once, and consumer check transactions reported not at all. IRPAC believes that the analysis applied to this correct approach can equally be applied to transactions reported under section 3402(t), the so-called 3 percent reporting/withholding provision applicable to certain government agencies.

IRPAC agrees that transactions with withholding need to be reported, but believes that IRS should first define reportable payment under section 3402(t) as one that does not include transactions under section 6050W. The statute clearly shows that Congress intended to not have the same transaction reported twice, and provided a number of rules to achieve that result. Section 6050W was not in existence when section 3402(t) was enacted; it followed by more than three years. Therefore it is not surprising that the earlier statute does not address the latter. However, the Managers Report for section 6050W clearly shows that Congress intended IRS provide rules for avoiding duplication with earlier provisions. Therefore, IRS should define reportable payment under section 3402(t) as not including reportable transactions under section 6050W. This will achieve the intent of both sections by insuring complete reporting—but only once--under section 6050W for all card transactions.

In addition to the overlap between sections 6050W and 3402(t), duplication will occur in another venue, namely the accounts payable function. Where a payor has outsourced the accounts payable function, that shared-service organization is already filing Forms 1099-MISC for payments to merchants. That same organization will now qualify as a third party network and be required to report again to the same merchants for the same payments on Form 1099-K if payments exceed the de minimis thresholds. This result is highly undesirable. IRPAC recommends that IRS provide that in such a situation, the shared-service organization be required to file only once, and that section 6041/Forms 1099-MISC take precedence over section 6050W/Form 1099-K.

Electronic Payee Statements

Section 6050W provides that payee statements may be furnished electronically. Commentators suggested that the existing affirmative consent procedures for electronic statements be eliminated for payments reported under section 6050W. The IRS did not adopt this suggestion in the proposed regulations, but did request whether consent procedures should be modified. IRPAC's views and suggestions are set forth below.

When IRS first authorized electronic payee statements, it addressed certain concerns about the switch from paper statements. In particular, IRS wanted to make sure that any recipient who wanted a paper statement could get one. And it wanted to be sure that the recipients were capable of receiving a statement electronically. To accomplish this, the IRS established a series of steps to be taken by the payors who wanted to issue electronic payee statements including a regular surface mailing to the recipient, another surface mailing back from the recipient to the payor, and a demonstration of electronic capacity by the recipient. These steps were thought to be important to protect consumers from being forced to switch to electronic statements when they were uninterested in or incapable of doing so.

The situation here is quite different. First, this is a business, not consumer, relationship. The relationship is negotiated between the parties. Merchants that do not want electronic statements could easily switch to another acquirer that would provide them with paper statements. Acquirers try hard to retain each merchant in their portfolios; such a loss would not be taken lightly.

Second, this is a business based on electronic communications. Transactions are conducted electronically. Payments are made electronically. Most communications are sent electronically. Though some merchants continue to receive business communications on paper, as time passes, that number is growing smaller and smaller.

For any merchant currently receiving business communications electronically, both IRS concerns described above and expressed in the existing payee statement rules have already been addressed. The merchant clearly is both willing and able to receive important information electronically. Adding Form 1099-K to the other important communications should be permitted without an actual surface mail communication to the merchant (who may well toss it in the trash as advertising—after all, all important communications are received electronically), a return surface mail communication from the merchant (who would prefer to communicate electronically), and a demonstration of merchant capacity to communicate electronically (which it does every day).

IRPAC believes that such archaic steps provided in a consumer context eight years ago when electronic communications were still in their infancy should not be imposed here. At most, if IRS believes that merchants need to be actively told that the new payee statement will be sent to them electronically, that message should be permitted to be sent electronically. If IRS believes that the merchant should be given a choice in the matter (other than the obvious choice to take its business elsewhere), merchants should be given an opportunity to opt OUT, not required to opt in, after receiving that electronic communication. Further, the opting out process should be conducted electronically in accordance with existing business communication standards.

For merchants currently receiving business communications on paper, a surface mailing to them to notify them of the option of receiving the Form 1099-K payee statement electronically may be desirable. For these paper-based merchants, opting IN should be completed by logging on to the PSE/EPF web site and providing its e-mail address; no return surface mailing should be required. Such a standard provides the proof of both the desire and capability to receive the statements electronically.

By employing these guidelines, IRS will ensure that those that want paper will get paper, and the far larger majority that want electronic statements will get them, without burdening PSE/EPFs or the merchants with unnecessary, old-fashioned, backward-focused standards devised eight years ago (when fewer payees had developed the in-touch-all-the-time habits of today), and in a different, consumer-oriented context. Business processes are different today. Business communications also are different, and B2B[12] relationships are different than consumer-oriented transactions. The payee statement rules should take cognizance of how business is done now and in the future, and not how it was done years ago. IRPAC urges IRS to adopt forward-looking rules that recognize developments in an electronic, B2B world.

<u>Additional Examples—Private Issue Cards, Mall Cards, and Related Entity Shared Services</u>

In response to IRS's request for additional examples to be included in the regulations, IRPAC suggests the following to clarify that the exception for closed loop cards includes situations where the credit and processing activity are performed by an outside party, but not to situations where multiple unrelated merchants are involved.

Example 1 - Private Issue Cards[13]—Retailer Credit
Bank B enters into an agreement with unrelated Retailer R to provide credit card services to R. Under the agreement, B will evaluate applicants submitted by R; qualified candidates are extended credit by R which is limited to usage at R's stores and online site, including related subsidiaries or brother-sister corporations. When a cardholder uses the card/account to purchase goods at

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[12] Business-to-business transactions which excludes consumer-related transactions such as bank deposit interest, and reportable dividends and stock sales that are the focus of most of the existing reporting and withholding rules.
[13] Private issue cards are commonly known as "store cards". They are issued to be used at a single store or related group of stores rather than the widespread usage offered by general usage cards.

R's sites, a billing statement is sent to the cardholder by B showing the name of R as the sender. B credits cardholder payments (less its service fee) to R when they occur. Any failure to pay by the cardholder is borne by R. Under the above facts, B is agent for R. Neither B nor R are subject to the provisions of section 6050W since the transaction is not one conducted by a "network of persons unrelated to each other and to the issuer who agree to accept such cards as payment."

Example 2 - Private Issue Cards—Bank Credit
Bank B enters into an agreement with unrelated Retailer R to provide credit card services to R. Under the agreement, B will evaluate applicants submitted by R; qualified candidates are extended credit by B which is limited to usage at R's stores and online site, including related subsidiaries or brother-sister corporations. When a cardholder uses the card/account to purchase goods at R's sites, B pays R the transaction amount less its fee. A billing statement is sent to the cardholder by B showing the name of R as the sender. Any failure to pay by the cardholder is borne by B. Under the above facts, B acts as both the issuer of the card and as the acquirer of the merchant. Though B and R are not related, B is not subject to the provisions of section 6050W since there is only one or more related merchant involved, and the transaction is not one conducted by a "network of persons unrelated to each other and to the issuer who agree to accept such cards as payment."

Example 3 - Mall Cards
Forty unrelated stores in a mall enter into a joint marketing agreement whereby they engage Bank J to process a mall card program. Under the terms of the card program, Customers may purchase gift cards for use at any of the mall stores. Tough the card is a limited-usage card restricted to activities with participating merchants in the mall, because there are multiple, unrelated merchants and an issuer, the mall card meets the definition of a stored value card and is reportable under this section.

Example 4 - Shared Services—Related Parties
Six related entities, all part of a consolidated group of corporations, share a single accounts payable department. Since the parties are related entities the shared AP function does not constitute a third party network and reporting under section 6050W does not apply. Reporting under section 6041 should be determined under that section.

Reporting to Foreign Merchants

Under section 6050W, a PSE is not required to report payments to a participating payee with a foreign address, except as provided in regulations or other guidance. Under the proposed regulations, however, no reporting is required only if payee has provided the U.S. payor or middleman PSE[14] with documentation upon which the PSE may rely to treat the payment as made to a foreign person in accordance with Treas. Reg. §1.1441-1(e)(1)(ii)[15]. On the other hand, a PSE that is not considered a U.S. payor or middleman is not required to report payments to participating payees with a non-U.S. address as long as the PSE neither knows nor has reason to know that the participating payee is a U.S. person. Therefore, a PSE that is a U.S. payor or middleman will be obligated to collect documentation from a merchant with a foreign address to exclude such merchant from reporting under section 6050W. A PSE that is not a U.S. payor or middleman can rely on the foreign address rule as written in the statute. Should the regulations produce an effect of discarding the foreign address rules for payments made by U.S. payor PSEs, a result that seems to be the exact opposite of what Congress intended?

In addition, in most cases, a U.S. payor PSE will not be making payments outside the U.S. to an offshore account, and thus will be obligated under the proposed regulations to collect Forms W-8 from merchants with foreign addresses. Should Forms W-8 be the only form of acceptable documentation that can be collected by these U.S. payor PSEs or should they have the option of also collecting documentary evidence (which, as a standard practice, may already be collected by PSEs) to prove the foreign status of the merchant? And should non-U.S. PSEs that are CFCs of U.S. entities (or otherwise considered U.S. payors) be obligated to collect either Forms W-8 or documentary evidence from merchants with foreign addresses when PSEs that are non-U.S. payor PSEs have no obligation to collect such documentation? Further, the proposed regulations do not address whether the presumption rules under section 6049 apply in this context.

On a related matter, IRPAC also asks that IRS clarify the treatment of merchants on U.S. military bases abroad. Under the proposed regulations, it would appear that such bases are considered to be outside the U.S. since they are not in the fifty states or the District of Columbia.

De Minimis Rules for Third Party Networks

[14] The phrase “U.S. payor or middlemen” includes not only U.S. PSEs, but also foreign branches and controlled foreign corporations (CFCs) of U.S. PSEs.

[15] That regulation permits reliance on Forms W-8 and, for payments made outside the U.S. with respect to an offshore account, documentary evidence. For individual payees, documentary evidence would typically include a passport or some other government issued form of identification. For non-individuals, documentary evidence would typically include formation documents such as a certificate of incorporation or partnership agreement that shows the country of formation of the entity. An offshore account is one maintained at an office or branch of a U.S. or foreign bank or other financial institution. In the absence of documentation, a U.S. payor PSE would be obligated to treat a merchant a U.S. person subject to reporting under section 6050W.

IRS requested comments on whether the de minimis rules for third party networks be made mandatory. IRPAC strongly suggests it should not. In fact, mandatory de minimis rules would appear to be contradictory to the IRS' desire for improved compliance as the result would be fewer returns being filed. No other de minimis rules have ever been made mandatory. For example, see the rules related to the $600 threshold for reporting under section 6041 and the similar $10 threshold rules under section 6049. Many payors routinely file returns for lesser amounts because it is easier for their systems to do so. Mandatory de minimis rules could also result in filers being penalized by IRS for reporting for transactions below the threshold (not to mention increasing communication problems between the networks and their clients.) This curious result is undesirable. IRPAC suggests that observing the de minimis rules should be voluntary.

* * *

IRPAC appreciates this opportunity to comment on the proposed regulations issued under section 6050W and remains committed to assisting IRS as it proceeds to finalizing the rules. If you have any questions about any of these matters, or any other related issue, please do not hesitate to contact me.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
Chair
2010 IRPAC

CC: Barbara Pettoni, Office of Chief Counsel

Appendix L
IRPAC Comments on Changes to IRC § 6041 (May 24, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

May 24, 2010

Mr. Keith Brau and Ms. Barbara Pettoni
Office of Chief Counsel (Procedure and Administration)
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Mr. Brau and Ms. Pettoni:

The Information Reporting Program Advisory Committee ("IRPAC") would like to request clarification regarding the scope of the recent amendments to Internal Revenue Code ("Code") section 6041. In particular, IRPAC would appreciate confirmation that the elimination of the reporting exemption in new section 6041(h) will not prevent corporate payees that qualify for exemption from reporting based on factors other than their corporate status (e.g., as a foreign person) from being treated as exempt from reporting under section 6041. Additionally, IRPAC would appreciate confirmation that new section 6041(h) is intended only to override the corporate exemption under section 6041 and not the exemptions under other Code sections, including sections 6042, 6044, 6045, 6049, and 6050N for payments of dividends, patronage dividends, gross proceeds, interest, and royalties, respectively, made to corporations.

LEGISLATIVE AND REGULATORY BACKGROUND

New section 6041(h), enacted as part of the health care legislation, provides that, for purposes of section 6041, the term "person" includes any corporation (other than tax exempt organizations). The provision applies notwithstanding any regulations issued prior to the date of enactment.

The health care legislation also amended section 6041(a). As amended, section 6041(a) requires the reporting of payments to "another person, of rent, salaries, amounts in consideration for property, premiums, annuities, compensations, remunerations, emoluments, gross proceeds, or other fixed or determinable gains, profits and income" other than, inter alia, payments to which sections 6042(a)(1), 6044(a)(1), 6049(a) and 6050N(a) apply, or with respect to which a statement is required under the authority of section 6042(a)(2), 6044(a)(2) or 6045. The amendment added the terms "amounts in consideration for property" and "gross proceeds" to the list of payments reportable under section 6041.

The Joint Committee's explanation related to these section 6041 changes provides:

> Under the provision, a business is required to file an information return for all payments aggregating $600 or more in a calendar year to a single payee (other than a payee that is a tax exempt corporation), notwithstanding any regulation promulgated under section 6041 prior to the date of enactment. The payments to be reported include gross proceeds paid in consideration for property or services. However, the provision does not override specific provisions elsewhere in the Code that except certain payments from reporting, such as securities or broker transactions as defined under section 6045(a) and the regulations thereunder.

The section 6041 regulations provide a list of persons to whom reporting is not required, including a domestic or foreign corporation[1] and also exempt certain "foreign related items" including payments to known or presumed foreign persons from reporting.[2] Further, the section 6041 regulations provide that the payments reportable under section 6041 do not include any "payments of amounts with respect to which an information return is required by, or may be required under authority of," a number of Code sections, including section 6042(a) (relating to dividends), section 6044(a) (relating to patronage dividends), section 6045 (relating to brokers' transactions with customers and certain other transactions, sections 6049(a)(1) and (2) (relating to interest) and section 6050N(a) (relating to royalties).[3]

ISSUES RAISED BY NEW LEGISLATION

This letter addresses two issues raised by the new legislation. The first issue is whether the legislation requires reporting under section 6041 to a corporation even if the corporate payee would otherwise qualify for some other reporting exemption under section 6041. The second issue is whether the legislation eliminates the corporate

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[1] Treas. Reg. §1.6041-3(p). The regulation excepts from the exemption certain payments, such as attorney's fees and payments for certain medical and health care services, made to corporate payees. See Treas. Reg. §1.6049-4(c)(1)(ii)(A) and section 7701(a)(3).

[2] Treas. Reg. §1.6041-4(a).

[3] Treas Reg. §1.6041-1(a)(1)(ii).

exemption from reporting not only under section 6041 but under other reporting sections, such as sections 6042, 6044, 6045, 6049, and 6050N, as well.

With respect to the first issue, the members of IRPAC are of the view that the language in new section 6041(h) is intended to say that a payment to a corporation is within the scope of section 6041 and potentially reportable. In other words, a payment to a corporation would be reportable under section 6041 if the corporation is not otherwise eligible for exemption on a basis other than being a corporation – e.g., as a non-U.S. person. However, we have heard that some people may be interpreting the language as suggesting that a corporation is *in all circumstances* subject to reporting under section 6041. This view is based on a concern that the override in new section 6041(h) of regulations issued prior to the date of enactment not only overrides the language in Treas. Reg. §1.6041-3(p)(1), which provides the corporate exemption per se, but also overrides any regulation that provides any exemption that a corporation may claim on any basis.

Therefore, under this view, the exemption in Treas. Reg. §1.6041-4(a) for payments made to a non-U.S. person, for example, would not apply for payments made to a foreign corporation. The reference to tax exempt organizations in new section 6041(h) may be read as supporting the view that the only corporations that *can* claim exemption under section 6041 are tax exempt corporations.

With respect to the second issue, there seems to be a view that, because section 6041(a) covers a broad range of fixed or determinable income payments, the elimination of the corporate reporting exemption in new section 6041(h) applies to all types of income, meaning it applies not only to those payments reportable under section 6041 but also those payments that could fall within the scope of section 6041 because they are excepted from reporting under other Code sections. Those holding this view point out that the statutory carve-outs for sections 6042, 6044, 6045, 6049 and 6050N and other sections in section 6041(a) only apply to amounts to which those sections *apply* or to amounts that are *actually reportable* under those sections. Thus, the concern is that amounts that are excluded by the regulations under those sections (for example, because the payee is a corporation) get picked up under section 6041 and thus are reportable if paid to corporations.

The members of IRPAC are of the view that this reading is inconsistent with Treas. Reg. §1.6041-1(a)(1)(ii) which clearly provides that amounts that are within the scope of other reporting provisions but specifically excluded from such reporting (because, for example, the payee is a corporation that is an exempt recipient), are not subject to reporting under section 6041. The reading also seems to be inconsistent with the Joint

Committee on Taxation's explanation of the amendments to section 6041, which states that the amendments do not override specific provisions elsewhere in the Code that except certain payments from reporting. For instance, section 6049(b)(4)(A) provides a statutory exception to reporting for payments to corporations unless otherwise provided in regulations.[4] The section 6049 regulations support the statute by providing that information reporting is not required for interest payments made to exempt recipients, including corporations. IRPAC believes the reporting exemption for interest payments made to corporations is still applicable.

Those of the other view, however, would suggest that because section 6049(b)(4)(A) excludes corporations from reporting under section 6049, interest paid to a corporation is subject to reporting under section 6041 absent an exemption. Since section 6041(h) eliminates the exemption for payments made to a corporation, the interest payments would be reportable under section 6041, notwithstanding the exemption in section 6049(b)(4)(A). IRPAC believes that, if this was really the intent, Congress would have simply repealed sections 6049(b)(4)(A) and 6042(b)(2)(B). IRPAC believes that the retention of the statutory exemption for corporation under sections 6042 and 6049 strongly indicates that the new provision in section 6041(h) is not intended to apply outside the scope of section 6041. In addition, the elimination of the corporate exemption under sections 6042, 6044, 6045, 6049, 6050N and other provisions of the Code would be a sweeping change in the scope of those provisions. The Joint Committee on Taxation's description of the amendments to section 6041 belies an intent to apply the amendments to section 6041 in such a broad manner.

SUMMARY

IRPAC believes that a plain reading of new section 6041(h) and the legislative history, as well as the remainder of existing section 6041 and the regulations thereunder, leads one to conclude that, to the extent a payment is within the scope of section 6041, a payee that is a corporation is no longer exempt because it is a corporation but may still claim exemption from section 6041 reporting on another basis – e.g., by being a non-U.S. person. Further, the legislation did not generally change the scope of section 6041 so that payments that were not previously reportable under section 6041 still are not reportable.

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[4] There is a similar statutory and regulatory exclusion for the reporting of dividend payments made to corporations. See section 6042(b)(2)(B) and the regulations thereunder.

Notwithstanding IRPAC's view, we have heard that some people may be interpreting the language as suggesting that section 6041(h) could imply that corporations are, without exception (other than tax exempt corporations), subject to reporting under section 6041 and also that the revisions to section 6041 effectively override the corporate exemptions under other Code sections.

IRPAC requests that the IRS provide clarification regarding the intended and expected interpretation of the scope of amended section 6041. IRPAC would be grateful if IRS could provide guidance as quickly as possible given the systems and procedural changes that payors must make in order to comply with the new provisions. If you have any questions, do not hesitate to contact us.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
2010 IRPAC Chair

Appendix M
IRPAC Comments on Notice 2010-51: Information Reporting Under the Amendments to Section 6041 for Payments to Corporations and Payments of Gross Proceeds and With Respect to Property (August 19, 2010)

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

August 19, 2010

Hon Douglas Shulman
Commissioner of Internal Revenue
CC:PA:LPD:PR (REG-139255-08)
Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2010-51

Dear Commissioner Shulman:

The Internal Revenue Service (IRS) Information Reporting Program Advisory Committee (IRPAC)[1] is pleased to submit for your consideration the following comments regarding Notice 2010-51 on the legislative changes made to Internal Revenue Code (IRC) section 6041[2] by the Patient Protection and Affordable Care Act of 2010 (PPACA)[3]. Our comments address numerous implementation issues for both the IRS and the filer community.

Exponential Increase in Filing; Burdens on the IRS

Information reporting of payments under section 6041 has been required for over sixty years for those in a "trade or business". Experience has shown that the vast majority of such business-to-business (or B2B) transactions are for merchandise or are with corporations, transactions which heretofore have been exempt from the reporting requirements. As a result, typically a payor will have to file Forms 1099-MISC under section 6041 for just five or ten, or in some cases up to twenty, percent of the transactions conducted annually. With the expansion of reporting required under the

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[1] IRPAC was established in 1991 as a result of an administrative recommendation contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the IRS consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system."
[2] Hereafter, all section references are to the Internal Revenue Code.
[3] P.L. No. 111-148, 124 Stat. 119.

recently enacted changes to section 6041, IRPAC expects the volume of filing to increase exponentially, reasonably estimated by experienced filers in most cases to be at least ten-fold. Since approximately 86 million Forms 1099-MISC are already filed each year[4] by over 4.2 million filers[5], this means that IRS potentially will receive close to one billion[6] such forms annually. Further, if the current percentage of forms filed on paper stays the same[7], IRS potentially will receive over 370 million paper Forms 1099-MISC each year. That is over six times the total number of ALL information returns currently filed on paper.

These paper returns are likely to be filed in small numbers by large numbers of filers. For example, for 2008, 1.2 million filers each filed ONE return, (presumably most of them on paper). An additional 1.8 million filers filed between two and five returns.[8] Only 25,760 filers filed more than 200 returns, which is still below the threshold for mandatory electronic filing. The additional resources necessary to process such a dramatic increase in volume overall, and paper returns in particular, will be significant.

In addition to processing original returns, IRS also will have to process an increased number of corrections. It is expected that the initial correction rate will be higher than the existing correction rate for Forms 1099-MISC as new filers—most of whom are likely to be small businesses—file for the first time. New filers, expanding filing, and more corrections also likely mean an increase in the number of B Notices and Penalty notices to be sent to payors and a greater drain on IRS resources to support such programs and filers.

Further, IRS will need additional resources for processing those additional Forms 1099-MISC for the Federal/State filing program. Thirty-one states participate in that program; most of them, if not all, receive information from Forms 1099-MISC from the IRS.

Other demands on IRS resources could include:
1. Revision of Form 1099-MISC or the creation of a new form to be used to report merchandise transactions;
2. Reconciliation of the data from the information returns filed with corporate tax returns[9];

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[4] Of the 86 million or so returns filed for 2009, approximately 54 million were filed on non-paper media (diskettes, etc.), and 32 million were filed on paper. Source: IRS document 6961 (Rev. July 2010).
[5] 4,244,131 unique filer EINs filing Forms 1099-MISC for 2008. Source: IRS Statistics of Income Division.
[6] Because of the “anti-duplication” rule of Treas. Prop. Reg. §1.6041-1(a)(1)(ix), the number of returns filed under section 6041 may not swell as much as otherwise would be the case if payors switch to using payment cards rather than checks or cash.
[7] It might be reasonable to assume that since many of the new filers of information returns will be small businesses, the percentage of forms filed on paper may well increase. But for this discussion, we are assuming it will remain the same.
[8] Statistics provided by the IRS Statistics of Income Division.
[9] See the section “Major Barriers to A Document Matching Program” which follows.

3. A significant increase in the number of underreporter cases, many of which will not result in increased revenues;
4. An increase in non-filer cases, many of which may result from information returns filed for subsidiaries included in a consolidated return;
5. An increase in appeals and litigation as any mismatches between information returns and tax returns work their way through the IRS system; and
6. A need for more highly skilled IRS employees to deal with the more technical and complicated business returns involved in the above processes.

Major Barriers To A Document Matching Program

IRPAC recognizes the value of information reporting. However, that value is based in large part not only on the quality of the data provided, but also on the ability of the IRS to match the data to tax returns. There are several factors why the increased reporting demanded by these changes will not translate into improved compliance:

1. *Cash/Accrual*. Information reporting is done on a cash basis. A payor reports what it paid when it paid it.[10] Many, if not most, corporations maintain their books on an accrual basis. This means that no matter how diligent a payor is in providing accurate data, and no matter how diligent IRS is in processing it, it will be virtually impossible to do an automatic match between the information return and the tax return.

2. *Fiscal/Calendar*. Information reporting is done on a calendar year basis. While virtually all individual tax returns are done on a calendar year basis, making document matching possible, many corporations file their tax returns on a fiscal year basis. As a result, no accurate document matching would be possible between a fiscal year tax return and a calendar year information return, especially when combined with possible cash/accrual accounting method disconnects.

3. *Basis*. Transactions for goods are to be reported on a gross proceeds basis, reflecting the only number a payor knows, the sales price, rather than adjusted for basis of goods sold. Any document matching between tax returns and information returns will need to be structured to take into account the difference between proceeds and income.

4. *Consumer Transactions*. The reporting requirements apply only to those in a trade or business. Since consumers are not required to file information returns any matching between returns filed by businesses and the payees will not mean much, particularly where the taxpayer's business is consumer-oriented. IRS will be unable to draw any reliable conclusions about a taxpayer's level of compliance where the amount claimed on the tax return is at least the amount reported by businesses.

5. *Foreign Income*. In our ever-shrinking world, many businesses have foreign operations, some limited to just Canada or Mexico, and some operating worldwide. As

[10] One exception is the reporting of original issue discount under section 6049, which is done even when actual payments are not made.

with the consumer issue discussed above, income from outside the United States can complicate any attempt to document match by masking domestic income.

6. *Affiliated Groups*. Many related entities file consolidated tax returns under the name and EIN of the parent corporation. IRS would need a methodology to associate an information return filed in the name of the subsidiary to the tax return filed by the parent.

Other Considerations

There are a number of other factors IRS must consider when designing its own systems to handle and utilize any data reported under the expansion of the section 6041 filing requirements. These include:

1. Pension plans often use corporate sponsor EINs, thereby confusing the question of whose income it is.

2. Corporate transactions are more complicated and technical, providing challenges on what should be reported and when, with the payor taking a position on when the deduction occurs, and the payee taking a different position on when the income accrues.

3. Some income may be non-taxable or tax deferred, thereby skewing any relevance of the information return.

4. Payments may be allocated among related corporate members, or paid to consolidated group members, either treatment sure to complicate utilization of the information reported.

Because this tremendous increase in the need for IRS processing resources is unlikely to be met in the short term due to limited budget resources, IRPAC is concerned that the filing community may be expected to shoulder its equally burdensome processing requirements to meet the new statutory requirements for no measurable purpose. If IRS is unable to adequately process and utilize the data provided, payors should not have to file. Suggestions for exceptions from the filing requirements to minimize the burdens on the payor community are provided below.

Exceptions

The statute provides that IRS has the authority to issue "such regulations and other guidance as may be appropriate or necessary to carry out the purposes of this section, <u>including</u> rules to prevent duplicative reporting of transactions." The plain meaning of this is that duplicative reporting is one reason to create exceptions, but this language does not in any way suggest that the regulatory authority is limited to preventing duplicative reporting. If Congress meant to limit the authority to duplicative reporting issues, it could easily have done so. In addition, while the legislation retracts two regulatory exemptions in existence, it does not prevent the creation of new exemptions. The Administration's FY2010 Green Book, in which this proposal first surfaced, specifically said that "Regulatory authority would be provided to make appropriate exceptions where reporting would be especially burdensome." Regulations limiting the scope of the provision are not only permitted, but required to carry out the purposes of the provision. Collecting, for the sake of collecting, unusable data is not a purpose of the provision.

IRPAC strongly urges the creation of exemptions where IRS has limited ability to utilize the data, or where the value of the data provided would be outweighed by the burden to collect and process it.

IRPAC suggests IRS provide optional exceptions for the following payee types. It is important to stress that these exceptions should be optional, and not required of any payor. In some circumstances, it may be more burdensome for a payor to establish and maintain systems to determine which of its payees are exempt than for the payor simply to report payments to all such payees. Thus, each payor should be free to apply any exception to any transaction and to any merchant, and to change its application or exclusion of any exception at any time for any purpose. Each payor should be free to refuse a claim for exemption submitted by any payee. In addition, IRS should provide that no payee has any cause of action against any payor for its election to report or not report under the exceptions provided.

1. *Tax Exempt Organizations*. The statute provides an exception for “tax exempt corporations.” IRPAC is concerned that many payors, especially many new small business payors, may not understand this term. The regulations should clearly state what type of organization is covered by this exception. Payors should be able to identify these payees through the traditional “eyeball” test: if the name of the payee is clearly recognizable as that of a qualifying section 501(c) organization, no documentation of that fact should be required. If there is a question of a payee’s qualification for this exemption, Form W-9 could be used (see Form W-9 discussion, infra.)

2. *Governments*. The regulations should clearly provide that this exception includes all Federal agencies, as well as all state and local government agencies, and their subdivisions and instrumentalities and Indian tribes, as well as foreign governments and foreign central banks of issue. Payors should be able to identify these payees through the traditional “eyeball” test: if the name of the payee clearly indicates its government status, no documentation of that fact should be required. If there is a question of a payee’s qualification for this exemption, Form W-9 could be used (see Form W-9 discussion, infra.)

3. *International Organizations*. Any organization on the State Department’s list of international organizations[11] should be exempt from these requirements. As with governments and tax-exempt organizations, this should be permitted without

[11] 22 USC § 288.

certification on Form W-9 particularly since the list is maintained by a Federal Government agency.[12]

4. *Publicly Traded Entities*. The expansion of reporting under section 6041 is aimed at improving tax compliance. Entities traded on public exchanges are unlikely to be fruitful sources of additional tax revenues as a result of document matching. Any payee identifiable as being traded on a recognized American stock exchange should be excludable from the reporting requirements.

5. *Publicly Regulated Entities*. As with publicly traded entities, any other entity that is publicly regulated should be excludable for the same reason: since it already is scrutinized, document matching is unlikely to be helpful in identifying any tax compliance issues. Examples of such entities would include banks, savings and loans, thrifts, building and loans, and other similar entities; securities and commodities brokers and dealers; and cooperatives and other entities whether operating for profit or in a quasi-governmental function that offer telecommunications, water, gas and electricity supply.

6. *Financial Institutions including Banks, Securities and Commodities Brokers and Dealers, REITs, RICs, and Common Trust Funds*. If the publicly regulated or publicly traded exceptions are not adopted, IRPAC recommends that a specific exception be created for financial institutions. These entities often receive income on behalf of different divisions, or different customers, making document matching a fruitless endeavor.

7. *Affiliated Groups*. Information reporting is based on the concept of unrelated parties providing information about arms-length transactions. Where both parties are within the same affiliated group, the utility of the data is marginal and outweighed by the burden of providing it. In addition, many corporate groups may be required to develop elaborate systems to develop and track the information required to permit reporting of intercompany transactions. Transactions between members of affiliated groups as defined in section 1504 should be exempted from the new reporting requirements.

Under any of the above exemptions, a payor should be able to unilaterally exempt any payee from the reporting requirements based on publicly available information such as the listings on a stock exchange or information provided on a payee's web site. Where a payee claims an exemption from reporting by submitting a Form W-9 with the "Exempt payee" box checked, the payor receiving this claim should be permitted to rely on the form absent actual knowledge to the contrary. No validation or other authentication should be required.

Other exemptions. The regulations should make clear that all other existing exemptions not repealed by the PPACA continue to apply and that any entity that

[12] For withholding tax purposes, no documentation is required in order to establish the exempt status of such a payee. See Treas. Reg. §1.1441-8(d).

qualifies for such exemption is not disqualified by virtue of the fact that it is a corporation (provided the exemption is not predicated on its corporate status, per se) or because the transaction is for merchandise.

TIN Matching Issues

The IRS TIN Matching system is based on data on file with IRS. This means that to ensure a match, the filer must submit the payee's legal name and assigned TIN. However, significant numbers of businesses operate under "DBA" names. These "doing business as" names are highly promoted. Brand names become valuable assets, and can even be sold separately as such. Yet anyone using a DBA name could run the risk of a mismatch, followed by a "B Notice" and a penalty notice. Similar considerations may apply in the context of companies that are changing their names as a result of merger and acquisition activities or the development of new market brands.

IRPAC recommends that IRS undertake a file expansion for the TIN matching program and to review its current instructions for business name changes to support the more immediate need for updating the IRS' data base. By accessing publicly available data, IRS could provide matches for both legal and DBA names of a payee and would catch new branding and new names.

B Notices

If this expansion of the capabilities of the TIN matching system is not achievable, IRS should consider modifying the B Notice program for the first two years of the expanded reporting. This will give the payor community additional, sorely needed, time to improve its databases to solicit and secure legal names for reporting purposes. A "soft B Notice" could be sent for section 6041 filings for 2012 and 2013. This notice would require the filer to solicit accurate payee data but not require backup withholding. This would avert any mass withholding on compliant taxpayers resulting from the DBA/legal name disconnect.

Penalty Notices

Similarly, because of all the challenges facing IRS in upgrading its own systems to adequately deal with the expanded reporting, and all of the burdens on the payor community to modify its own processes, discussed throughout this letter, IRPAC recommends that IRS provide penalty waivers for 2012 and 2013 to payors making a good faith effort to comply.

Gross Proceeds

IRPAC directs IRS to our letter of May 25, 2010 in which we discuss the scope of the legislative changes. We reiterate here our conclusion that the changes made in the PPACA are limited to section 6041 and that the term "gross proceeds" is not intended to include transactions included in the scope of reporting under any other section, even if included and expressly exempted from reporting in that other section. It is our belief that the term "gross proceeds" merely refers to that requirement to report the sale amount of merchandise, not adjusted for basis.

IRPAC also recommends that IRS re-affirm its long-held positions on the scope of section 6041 reporting including:

1. Contractor expenses submitted under an accountable plan are not reportable; and

2. Property damage awards are not reportable as they are not "fixed or determinable".

Changes To Filing Rules Or To Form 1099-MISC

IRS should require of filers under section 6041 only the same things currently required under section 6041 and of other filers of other information returns including: (1) retention of the information or the ability to re-create it for 3 years from the later of the due date of the filing or actual filing date (4 years if any backup withholding is done); and (2) voluntary, not mandatory, TIN matching. IRPAC suggests that Form 1099-MISC be modified by utilizing either box 11 or box 12, currently not used, for the reporting of merchandise transactions. Further, the regulations should provide that if a single transaction involves both services reportable in box 7 and goods reportable in box 11 or 12, that existing tax rules be used to determine whether to report the entire amount in box 7 or in the box designated for reporting property.[13] The filer should not be required to separate out the service component from the property component.

Changes to Form W-9

Form W-9, Request for Taxpayer Identification Number and Certification, is not required to be used to provide a TIN under section 6041.[14] In fact, a payor is prohibited from demanding submission of the form as a term and condition of doing business with the payee.[15] However, Form W-9 may be used to provide the merchant's data if both parties agree. In addition, the form may be used by a payee to claim an exemption from reporting[16] or to establish U.S. status in the face of indicia of foreign status.[17]

These rules are often misunderstood by the payor community. IRPAC recommends that IRS take this opportunity to provide clarifying instructions for the Form W-9.

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[13] Generally, single invoices for combined goods and services are reportable in full in box 7 where the merchandise is incidental to the provision of the service. See Rev. Rul. 81-232, 1981-2 C.B. 231. Cf. PLR 9521003 (2/9/95) in which the Service found that the transaction was one for a finished product. We would encourage IRS to further refine this distinction.

[14] Treas. Reg. § 31.3406(d)-1(d).

[15] Rev. Proc. 96-26, 1996-1 C.B. 684.

[16] See Instructions for Form W-9.

[17] Treas. Reg. § 1.6049-5.

Backup Withholding

Section 6041 provides a threshold for reporting of $600 in a calendar year, a rule established in the statute in 1942 when the average salary was $1299 and the minimum wage was 43 cents per hour.[18] Backup withholding generally applies when a transaction is reportable, regardless of dollar amount, if a TIN has not been provided in the "manner required."[19] In the regulations under section 3402(t), IRS found that withholding on payments of up to $10,000 was undesirable because "the burden of withholding on smaller transactions is likely to be substantial and outweigh the benefits of increased withholding." If the burdens of withholding on transactions under $10,000 outweigh the benefits of the withholding, clearly no withholding should be required on any single transaction of less than $600 whether or not it is possible that future transactions could cross the annual aggregate reporting threshold of $600. IRPAC recommends that such an exception be provided for all transactions reportable under section 6041

In addition, if a payor chooses to report when not required, the payor should be encouraged to provide a payee TIN. However, the regulations should make clear that backup withholding is not applicable to any account voluntarily reported. Similarly, the provisions of the B Notice program and penalty program should not apply to such voluntary filings.

Payee Addresses

The regulations should provide that, if the payor has multiple addresses on file for a merchant payee, any address may be used to file both the IRS and payee copies of the information return. The payor should not be required to determine which address is the "correct" address. This will be particularly important for small businesses doing business with multiple locations of, e.g., an office supply store, without knowledge of whether the stores are in fact corporate-owned locations of the same entity or independent franchises, and without knowledge of the address of the corporate owner.

Issues For Payors

Just as IRS will need sufficient time to implement all the far-reaching ramifications of the PPACA changes to section 6041, the payor community also will need sufficient time to make any changes required by the regulations. In general, payors will need at least one year after final regulations are promulgated to implement system changes. Since it is unlikely that IRS will have issued final regulations by January 2011 (which would provide the requisite year for implementation), IRPAC strongly urges IRS to provide an extended transition period during which penalties will not be assessed for those making a good faith effort to implement the necessary changes to their systems. In addition, IRPAC urges IRS to provide that during this extended implementation

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[18] www.chacha.com

[19] Section 3406(a)(1)(A).

period, any B Notices issued under section 3406 be “soft notices”, that is, notices for which payors need only contact the payee for name/TIN information but are not required to impose backup withholding on any accounts.

Payors will need time to reclassify payees currently classified as exempt from reporting as reportable; since not every payee will be reportable, time will be needed to review all merchant records to ensure reclassification accuracy. This will be particularly important to the extent IRS provides exempt categories of payees as recommended earlier. If a payor chooses to use Form W-9 to identify payees exempt from reporting, additional resources will be necessary to handle the influx of certification forms.

For those payees that will now be classified as reportable, payors will need to solicit TINs if one has not previously been obtained. This could also include TIN matching to ensure data accuracy. For name/TIN data currently on payor systems, TIN matching may also be needed, especially to ensure that legal names are on file and not DBA names.

Payors will need to adjust their new accounts procedures to solicit TINs from new categories of payees, to ensure legal names are obtained and possibly to do TIN matching.

In addition, internal documents may need to be modified to clarify the scope of reporting and the need for legal name/TIN data from a broader range of payees. Internal operating manuals also will need to be updated to deal with the new reporting requirements. Personnel will need to be trained in these changed procedures.

Systems may need modification to deal with backup withholding. While backup withholding has been applicable to existing reportable payments under section 6041, since the scope of reporting was much narrower, payors often did it manually. With broader reporting requirements, it may be necessary to create an electronic system to deal with backup withholding on many more accounts.

All of these additional burdens obviously will require that financial resources be committed to achieve them. This occurs at a time when the business community is struggling to recover from a major recession. This burden may fall particularly hard on the small business community. IRS should strive for regulations that minimize the burdens on the filers.

Interrelationship Among Sections 6041, 6050W, and 3402(t)

Transactions in the business world are potentially subject to reporting under three separate sections of the Internal Revenue Code. To avoid some of the duplication, IRS has proposed that payment card transactions be reported under section 6050W and not under section 6041. IRPAC applauds this decision as it will serve not only to reduce burdens on filers, but also to minimize confusion on the part of taxpayers. IRPAC believes that the analysis IRS applied to this elimination of duplication can equally be applied to transactions reportable under section 3402(t), the so-called 3 percent reporting/withholding provision applicable to certain government agencies.

IRPAC agrees that transactions with withholding need to be reported, but believes that IRS should first define reportable payment under section 3402(t) as one that does not include transactions reportable under any other section. The statute clearly shows that Congress intended to not have the same transaction reported twice, and provided a number of rules to achieve that result. Section 6050W was not in existence when section 3402(t) was enacted; it followed by more than two years. Therefore it is not surprising that the earlier statute does not address the latter. However, the Managers Report for section 6050W clearly shows that Congress intended for IRS to provide rules for avoiding duplication with other provisions. Therefore, IRS should define reportable payment under section 3402(t) as not including reportable transactions under section 6050W. This will achieve the intent of both sections by insuring complete reporting – but only once – under section 6050W for all payment card transactions.

In addition to the overlap between sections 6050W and 3402(t), duplication will occur under sections 6050W and 6041 in the accounts payable function. Where a payor has outsourced the accounts payable function, that shared-service organization is already filing Forms 1099-MISC under section 6041 for payments to merchants. That same organization will now qualify as a third party network under section 6050W and be required to report again to the same merchants for the same payments on Form 1099-K if payments exceed the de minimis thresholds. This result is highly undesirable. IRPAC recommends that IRS provide that in such a situation, the shared-service organization be required to file only once, and that section 6041/Forms 1099-MISC take precedence over section 6050W/Form 1099-K.

Transactions undertaken by federal, state, and large local government agencies are subject to reporting under both sections 6041 and 3402(t). The statute and proposed regulations are clear that if a payor is withholding under section 6041, it is exempted from the requirements of section 3402(t). However, where backup withholding is not imposed, the statute and regulations fail to affirmatively state that the transactions should be reported only under section 3402(t), and that no reporting is required under section 6041. Without such a statement, the rules of both sections 3402(t) and 6041 could apply. IRS should make it clear that no one need file two forms for a single transaction.

IRPAC recommends that IRS adopt anti-duplication rules to complement those proposed in the section 6050W regulations, namely that governments subject to the section 3402(t) rules are relieved of any reporting under section 6041 even if an exemption under section 3402(t) results in no reporting required under that section, so that governments are not required to develop systems to implement both sets of reporting requirements. Applicable governments would report cash and check transactions only under section 3402(t) and all others would report such payments under section 6041. Payment card transactions would be reportable only under section 6050W.

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IRPAC appreciates this opportunity to comment on the issues raised by the recently enacted changes to section 6041. If you have any questions about any of these matters, or any other related issues, please do not hesitate to contact me.

Sincerely,

Lisa M. Chavez

Lisa M. Chavez
Chair
2010 IRPAC

CC: Keith Brau, Office of Chief Counsel