

# INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

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

Jon Lakritz  
Chairperson

**Ad Hoc**

**Sub-Group:**

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March 2, 2009

Mr. Stephen Schaeffer  
Office of Associate Chief Counsel (Procedure & Administration)  
CC:PA:LPD:PR (Notice 2009-17)  
Couriers Desk  
Internal Revenue Service

**Burden Reduction**

**Sub-Group:**

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

Re: Reporting of Customer's Basis in Securities Transactions – Notice 2009-17

**Emerging Compliance  
Issues**

**Sub-Group:**

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Maria Murphy  
Paula Porpilia  
Susan Segar

Dear Mr. Schaeffer:

The Information Reporting Program Advisory Committee (IRPAC)<sup>1</sup> appreciates the opportunity to provide comments on the development of a new cost basis reporting regime. We commend your efforts to seek comments from the public as you have done in Notice 2009-17 (the "Notice"). Cost basis reporting presents many complex challenges and will require close cooperation between the IRS and private industry. IRPAC can assist in this collaboration<sup>2</sup>.

**Modernization**

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Suzanne Sullivan

In addition to our preliminary response to the 36 specific questions in the Notice contained in the attached chart, we would like to address the following in this letter:

- Comment Period. The IRS should continue to accept comments from the public after March 2.
- Scope of the Notice. In addition to the points covered in the Notice, the IRS should address certain additional issues.
- Underlying Principles. The cost basis reporting regime should be guided by certain underlying principles.
- Priorities. The public should have an opportunity to comment on the priority in which guidance is issued.
- Penalties. IRS should exercise discretion when imposing penalties for failure to comply with new basis reporting rules.

**Office of Professional  
Responsibility**

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Teresa Douglass  
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<sup>1</sup> 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.

<sup>2</sup> IRPAC's Strategic Subgroup for Legislative Proposals has previously commented on basis reporting. See July 7, 2007 letter from IRPAC to Senate Committee on Finance (copy attached).

### **Extend the Comment Period in the Notice**

The IRS requests comments from the public on 36 issues that are relevant to cost basis reporting and that must be addressed. Some of these issues are complex and will significantly influence the development efforts that are currently being conducted by various impacted stakeholders (e.g., securities brokers, transfer agents, mutual fund companies, etc.). Although these entities (hereinafter collectively referred to as “Brokers” both in this letter and in the attached chart) have begun preparing for cost basis reporting since the legislation was enacted, much of the staff responsible for implementing the new regime is currently in the throes of meeting their annual tax information reporting responsibilities. Accordingly, it is most likely that these individuals would require additional time to prepare a thoughtful and complete written response to all 36 issues. Although guidance must be issued quickly in order to provide Brokers with adequate time to modify their information systems and business procedures, we urge you to consider comments received after March 2. An additional comment period of 30 to 60 days would be appropriate.

### **Additional Issues should be addressed**

In addition to the 36 issues mentioned in the Notice, the IRS should address the following:

1. **Content of Newly-Designed Information Returns and Basis Transfer Statements.**

The IRS should request comments on defining the content of newly-designed information returns<sup>3</sup> and basis transfer statements<sup>4</sup>. As Brokers plan to modify their information systems and business practices, one of the most important points of information needed in order to proceed with their projects is a definition of the data that they must capture, store, report and transmit. For example, Brokers need to know if the following data will need to be reported on 1099s and Basis Transfer Statements: (a) whether a security is covered; (b) the taxpayer's accounting method (FIFO, average cost, specific ID, etc.); (c) the source of the basis (from transferee broker, from taxpayer, etc.); (d) the acquisition date of the security; and (e) any special taxpayer methodology or elections in place for the basis calculation or other unique information that should be conveyed to an acquiring broker regarding basis information.

We note that recent “visual form” projects, like those in place for new Form 941X that partnered with the industry to develop the required schemas, should be considered as a model for the development of a newly-designed Form 1099- B and Basis Transfer Statements. IRS should also seek input from organizations such as SIFMA (the Securities Industry and Financial Management Association), ICI (the Investment Company Institute) and DTCC (the Depository Trust & Clearing Corporation).

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<sup>3</sup> Presumably, basis information would be required to be reported on a modified version of IRS Form 1099-B (Proceeds from Broker and Barter Exchange Transactions).

<sup>4</sup> Under new IRC §6045A, transferors of covered securities are required to furnish statements to transferee brokers that contain cost basis related information. These statements are hereinafter referred to as “Basis Transfer Statements.”

2. Information Reporting to Subchapter S Corporations. The IRS should ask for comments on the implementation of reporting gross proceeds and basis information to S corporations (SCorps). Under current law, there is no Form 1099-B reporting to corporations<sup>5</sup>, including SCorps. New IRC §6045(g)(5) requires Brokers, after December 31, 2011, to treat SCorps in the same manner as partnerships; thus subjecting SCorps to Form 1099-B reporting. The IRS needs to address several implementation issues to ensure that Brokers are able to transition to SCorp reporting in an orderly manner. The following issues should be addressed soon in order to provide sufficient lead time for implementation:

- a. Brokers currently are not required to know if their corporate clients are SCorps. Will Form W-9<sup>6</sup> be modified to require SCorps to identify themselves? An even more substantive question is whether Form W-9 should be modified for this purpose. We believe it important that any modifications to the W-9 not be made overly complex. Consideration should be given to simpler paths to identify these entities, while at the same time recognizing that since the reporting falls under IRC §6045, the TIN certification needs to be made under penalties of perjury.
- b. IRS needs to describe how the effective date of SCorp reporting will operate. Will SCorp reporting apply only to accounts opened after December 31, 2011, or will it apply to all accounts regardless of when opened? If it applies to all accounts, Brokers will most likely need to solicit information from their existing account population to determine whether their corporate accounts are SCorps. When promulgating rules, the IRS needs to recognize that the number of SCorps holding investment accounts is most likely small; it is difficult to justify the major expense of a mass mailing to all of a Broker's existing exempt recipient accounts just to uncover a small number of SCorps.
- c. Consideration needs to be given to allowing Brokers to also report any other 1099 information (e.g., interest and dividends) as part of a SCorp's composite payee statement even though not required. Extracting only 1099-B reportable information will require systemic capabilities that many Brokers do not have.
- d. IRS needs to address the impact on the so-called eyeball test<sup>7</sup>. Once SCorp reporting becomes effective, Brokers that use the eyeball test may need to modify their business practices if the IRS changes or repeals it. We suggest that the eyeball test be retained, with a caveat for SCorps. A repeal or significant modification of the eyeball test could result in undue disruption

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<sup>5</sup> Under current law, corporations are treated as exempt recipients. See Reg. §1.6045-1(c)(3)(i)(A).

<sup>6</sup> Request for Taxpayer Identification Number and Certification

<sup>7</sup> Brokers and other payors are currently permitted to treat corporate accounts as exempt recipients when the title of an account contains certain indicia of corporate status (see Reg. §1.6049-4(c)(1)(ii)(A)). For example, if the name of the payee contains an unambiguous expression of corporate status (e.g., Incorporated, Inc., Corporation, or Corp.), a payor or broker may treat the payee as an exempt recipient for purposes of various information reporting requirements, including gross proceeds reporting under Section 6045. Treating an account as an exempt recipient based solely on presence of these corporate indicia is referred to as the "eyeball test" by many Brokers. Brokers and other payors have used the eyeball test for decades as an easy way to determine whether certain corporate accounts are subject to information reporting, backup withholding and Form W-9 solicitation.

and burden for Brokers and their clients. It is difficult to justify the expense that might be incurred if the eyeball test is not retained.

3. Proposed Regulations on Calculating Cost Basis. The IRS should request comments regarding the impact that proposed regulations [Reg - 14386-07, issued January 21, 2009, under IRC §§ 301, 302, 304...] have on the ability of Brokers to develop and implement cost basis reporting systems. We are concerned that the complex method of calculating basis under these proposed regulations could impede the ability of brokers to modify their information systems and business practices in a timely manner. These regulations describe a system of stock basis recovery and stock basis allocation that is currently not used at any financial institution, and was not contemplated during the extensive deliberations on cost basis reporting that industry has had with Congressional and Treasury tax staff over the past several years.
4. Filing Corrected Information Returns and Basis Transfer Statements. The IRS should request comments on a Broker's responsibility to file corrected basis information returns and Basis Transfer Statements due to information it receives after it files its 1099s. For example, if a publicly traded corporation releases new information about its merger or one of its distributions three or four years after the event occurred, should a Broker be responsible for filing amended information returns and furnishing amended Basis Transfer Statements to reflect the new information? When should a Broker's responsibility terminate for purposes of filing corrected information returns? Brokers have traditionally had to contend with post year-end adjustments to events that they report on Form 1099-DIV (Dividends and Distributions). When new information is received shortly after year-end, a corrected Form 1099-DIV can easily be provided in due course with minimal disruption to taxpayers. However, when new information becomes available several years after the initial 1099 filing, amending information returns causes a significant disruption to taxpayers and Brokers. Preparing and processing amended information returns and recipient statements becomes unwieldy when several years have elapsed since the initial filing. Once basis reporting becomes effective, this dilemma is greatly exacerbated due to the new requirements to perform basis calculations and furnish Basis Transfer Statements. A Broker's responsibility to track new information for purposes of correcting 1099s and Basis Transfer Statements ought to terminate within a reasonable period of time. For further explanations of this concern, see items #14-15, #22, and #27-35 in the attached chart.

### **Underlying Principles Should be Considered in the Development of a Sound Cost Basis Reporting Regime**

Although Brokers, in general, should be well-positioned to be the main repository for basis information, they are unable to observe and track all of the events and taxpayer-level elections that could impact the basis of securities. We are concerned that customers may be given the flexibility to make or change elections in a manner that doesn't take into account what is workable for Brokers. In addition, there are numerous events that are extrinsic to a taxpayer's account with a Broker that could

impact a taxpayer's basis in their securities, and that are beyond the tracking means available to Brokers today.

Since it is impractical to require that Brokers be responsible for tracking all possible events and taxpayer-level elections that impact basis, **Brokers should be treated as passive repositories of basis information, rather than guarantors as to its accuracy.** The IRS should not strive for perfect reconciliation between the information reported on 1099s and the information on the taxpayers' tax returns. See items #7, 19, 23 and 30 in the attached chart for further clarification.

Viewing Broker-furnished basis information in this manner should guide IRS policy for a variety of purposes. For example, if Broker-furnished basis information is regarded as limited in scope, taxpayers should be advised of the possible adjustments required on their Form 1040 Schedule D (Capital Gains and Losses). Instructions to the Schedule D and related IRS publications should clearly explain the limitations of broker-furnished basis information and the need to make certain adjustments when preparing tax returns.

The requirement to transfer basis information from one Broker to another under new IRC §6045A will require close coordination between transferee and transferor Brokers. Ideally, communications among Brokers would be standardized. However, since Basis Transfer Statements will be generated by participants from a variety of different industries (e.g., securities brokerage, mutual funds, transfer agents, etc.), it is unlikely that a uniform means of communicating basis information will be developed and implemented in the near future. In recognition of the fact that Brokers will send and receive basis information using a variety of formats and utilities, is important that **one Broker's failure to provide required information, or voluntary provision of information that is more than what is otherwise required, should not affect another Broker's substantive obligations.**

### **Priority in which Guidance is Issued**

The IRS should consider issuing guidance on the new cost basis reporting regime in stages. As Brokers and other payors plan to modify their information systems and business practices, certain points of information are needed immediately; whereas other information may not be needed until a later date. The IRS should seek public comment to determine the optimal order in which guidance should be issued. IRPAC feels the following matters should be addressed first:

1. Clarify who is a middleman to which the rules attach.
2. Develop a vision draft of Form 1099-B and related instructions, and define the data that must be included on Basis Transfer Statements required under new IRC §6045A.
3. Clarify how to determine reportable S corporations<sup>8</sup>.
4. Establish a course of action for resolving conflicts in classification (e.g., debt versus equity) of covered securities and exempted securities.

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<sup>8</sup> See "Information Reporting to Subchapter S Corporations", page 3, *supra*.

5. Outline curative actions on the part of the beneficial owner (burden of proof) where a transferring Broker refuses to, or can't pass the information or passes unreliable information.
6. Develop acceptable processes for forensic basis development, as well as allowable uses of data from other sources apart from an upstream Broker who may have unreliable information.
7. Recognition and reconciliation of any conflicts with existing 1099-B regulations.
8. Even though reporting for mutual funds and options is extended further out (2011 and 2012), due to the very lengthy time line needed for developing new systems (3-4 years) and the involvement of many processing systems that will need to be changed to support compliance, the requirements need to be released as soon as possible so development can begin.
9. IRS should develop a glossary of terms and underlying principles, and consider adding it to the regulations to avoid reader confusion. (Glossaries are in both the existing backup withholding regulations and the 1441 regulations.) IRPAC offers to develop this glossary in collaboration with the IRS.
10. Make sure that the February 15 payee statement due date and its application to all consolidated forms is made a permanent part of the regulations.

### **IRS Should Exercise Discretion when Assessing Penalties for Failure to Comply with New Basis Reporting Rules**

The IRS should exercise additional discretion when imposing penalties for failure to comply with the new basis reporting rules, especially during the early years of the new regime. Basis reporting represents a major shift in responsibility for retrieving, maintaining and processing large amounts of data. Provisions should be made for relief or the lenient application of penalties in first few years of the new regime, in recognition of the following: (1) Complex systems development will take several years and in some cases actually affect the underlying trade processing systems; (2) The recent economic downturn has affected the financial community particularly hard so that funds needed for systems development and training are minimal to none; (3) Developmental issues are fairly complex, even on matters as simple as to who owns needed data, and it will take time to work through the processes; and (4) Financial servicers are traditionally not tax return preparers. This is a new venture that will require a substantial learning curve even for those with sophisticated cost basis systems already online. Staff must be trained to perform cost basis work. Reporting tax basis information requires a new business culture that involves taking ownership of what traditionally has been the client's purview.

Our comments reflect input from a variety of sources, including tax preparers, securities brokers, mutual fund companies, transfer agents and tax advisors. Due to the very short time frame in which we had to respond to the Notice, the attached chart contains our preliminary response to the 36 questions in the Notice. We intend to provide a more comprehensive analysis shortly. To the extent that we discover

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additional matters of importance that the IRS should consider in the rules-making process, we will inform you as soon as possible.

IRPAC looks forward to working with you to help ensure that basis reporting is introduced in a manner that is fair and workable for all stakeholders. If you have any questions, please contact the undersigned.

Sincerely,

Jon Lakritz  
2009 IRPAC Chair

cc: Douglas H. Shulman, Commissioner, Internal Revenue Service