Notice 2009-17

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LEGAL PROCESSING DIVISION
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March 16, 2009

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BY COURIER AND E-MAIL

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Re: Reporting of Customer's Basis in Securities Transactions – Notice 2009-17; Wolters Kluwer Financial Services Comments in Response to the Notice

Dear Mr. Schaeffer:

Please find enclosed Wolters Kluwer Financial Services comments in response to the specific issues listed in Notice 2009-17. We tried to answer every question in the Notice, but our answers are not exhaustive or necessarily complete. We hope to submit additional comments and further information at a later time. We also are willing to provide additional commentary or information upon request.

These comments have been prepared on behalf of Wolters Kluwer Financial Services by Stevie D. Conlon, Tax Director, GainsKeeper, Wolters Kluwer Financial Services, with assistance from Dale Collinson, Director, Financial Institutions and Products, KPMG Washington National Tax, and Steven M. Rosenthal, Esq., Ropes & Gray LLP.

We look forward to continuing to work with you towards a successful implementation of the new basis reporting legislation.

Best regards,

Steven M. Rosenthal

Enclosure

cc: Mr. Eric San Juan, U.S. Department of the Treasury
Stevie D. Conlon, Wolters Kluwer Financial Services
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Wolters Kluwer Financial Services
Comments in Response to Notice 2009-17

MARCH 16, 2009

INTRODUCTION

On February 6 2009, the Internal Revenue Service ("IRS") released Notice 2009-17, IRB 2009-8, inviting public comments on issues relating to broker cost basis reporting legislation enacted in 2008 and as set forth in Internal Revenue Code Sections 6045(g) and (h), 6045A, 6045B and 1012(c) and (d) (hereafter "Sec." shall generally refer to a section of the Internal Revenue Code).

Notice 2009-17 requests comments on 36 specific issues set forth therein. The comments set forth below, which respond to the specific issues listed in the notice, are not exhaustive or necessarily complete. We may submit additional comments or further explanations or amplifications of our comments set forth below at a later time. For example, we may submit additional comments on wash sales, options reporting and/or corporate action reporting by issuers. We also are willing to provide additional commentary or information upon request.

These comments have been prepared on behalf of Wolters Kluwer Financial Services by Stevie D. Conlon, Tax Director, GainsKeeper, Wolters Kluwer Financial Services, with assistance from Dale Collinson, Director, Financial Institutions and Products, KPMG Washington National Tax, and Steven M. Rosenthal, Esq., Ropes & Gray LLP. Wolters Kluwer Financial Services presently provides cost basis related financial information and technology to a significant number of brokers, transferors, issuers, customers and other persons affected by the new cost basis reporting law through its GainsKeeper and Capital Changes divisions. See www.gainskeeper.com and www.wolterskluwerfs.com/cap for more information.

These comments represent the views of the authors listed above and are based on their understandings and present law as of the date hereof. No other inferences should be made.

EXECUTIVE SUMMARY

Overall, the broker cost basis reporting legislation was intended to address the goals of reducing the tax gap and promoting tax simplification for individual return filers by generally requiring broker reporting that was expected to track customer reporting in most instances. In general, the broker cost basis reporting legislation did not modify or simplify various other basis adjustments that could apply. However, to support consistent reporting, the legislation simplified the reporting of wash sales by brokers and revised lot relief method determinations (i.e., the method to determine the cost basis of lots of stock that have been sold) under amended Sec. 1012. Thus, we believe that the objective of promoting consistency between broker basis reporting on information returns and customer basis reporting on tax returns should be given significant weight in addressing the issues set forth in the Notice.

APPLICABILITY:
With regard to the applicability of the broker basis reporting requirements, we believe that the definitions of a broker subject to basis reporting and an applicable person under Sec. 6045A should be broadened to minimize gaps in coverage. We recommend that the issuer's classification of a security as debt or equity should generally control for broker cost basis reporting purposes and that hybrid instruments and units that are treated as multiple instruments for tax purposes should be excluded from reporting unless and until the IRS issues guidance regarding their treatment.

BASIS METHOD ELECTIONS:
For stock and securities other than mutual fund and DRIP shares, we believe that current lot relief methods (including specific ID) should be available. For mutual fund and DRIP shares, a basis methodology should be selected by customers at the time they open an account and, if they fail to choose one, by their broker. We generally do not believe that a customer should be able to change from the average cost method once established. We believe that customers have a self-help method to change the method by opening a new account (regardless of whether they close an existing account), which would permit the establishment of a new lot relief method for newly acquired shares. We believe that the account by account rule permits average and wash sale calculations generally without regard to information set forth outside of each customer account.

DIVIDEND REINVESTMENT PLANS:
We recommend that stock is treated as DRIP stock only for the customer that has elected to participate in a DRIP plan and that only stock that is paying dividends at the time the issuer or broker begins offering a DRIP qualifies as DRIP stock. Other shares held by the customer that are not in a DRIP plan should not be included in the averaging calculation. Subsequent deposits or acquisitions of stock into a DRIP plan should be combined into a single aggregate averaging pool. We recommend penalty relief and a lower, good faith standard of care for data from pre-effective date shares that are included in an averaging pool due to the single account election.

Wolters Kluwer Financial Services
Comments in Response to Notice 2009-17

RECONCILIATION WITH CUSTOMER REPORTING:
We recommend greater specificity of reporting to provide detailed basis and gross proceeds information consistent with the requirement to report the short-term portion of gain or loss and the long-term portion of gain or loss, along with detail regarding any wash sale deferral affecting basis in connection with each sale transaction. We also believe that reporting for sales transactions should be broken out between the portion of a sale that relates to noncovered securities and the portion that relates to covered securities with no change in the manner of reporting the gross proceeds portion of such transactions relating to noncovered securities.

For consistency purposes, we believe that brokers should report cost basis using the lot relief method used by their customers and thus should support all available lot relief methods for such reporting. We recommend that Schedule D be modified to include a section reconciling cost basis reported by brokers with the amount reported by taxpayers and that taxpayers should attach a statement to their returns explaining any differences. We believe that based on present law a customer can identify or change the identification of specific securities for lot relief purposes until settlement.

SPECIAL RULES AND MECHANICAL ISSUES:
With regard to wash sales, we believe that the term "identical securities" should refer only to securities with the same CUSIP number and that if a security does not have a CUSIP number (e.g., a foreign security), a comparable identification number (e.g., SEDOL) should be used. We do not believe that the statute permits or was intended to provide any de minimis exceptions for wash sales. We generally believe brokers should apply present law in addressing the substantive law issues necessary to report basis for options. We recommend the IRS require the reporting of all short sales involving stock or other types of covered securities based on when such sales are closed rather than when they are opened. We believe the first applicable effective date year should be a transitional year to avoid differing types of reporting of short sales involving the same type of underlying security (such as stock).

We recommend that basis adjustments for debt securities (original issue discount, market discount, acquisition premium and bond premium) should be required because they are fundamental to the computation of gain or loss on the disposition of debt securities. However, we are concerned that the reporting of such adjustments without taking into account the specific purchase prices or various elections of the holders of debt securities would not address the policy goals of consistency and simplicity behind the basis reporting legislation.

We recommend that brokers should not be required to make gift and death-related basis adjustments for cost basis reporting purposes, which we believe is consistent with legislative intent. However, we note that many brokers and financial advisors currently provide gift and death-related basis adjustments to some of their customers as a customer service. We believe that the inclusion of such adjustments promotes consistency between broker reporting and taxpayer reporting. Accordingly, we further recommend that brokers and other applicable persons within the meaning of Sec. 6045A should be

permitted to make gift and death-related basis adjustments (although such adjustments would not be required). We believe that such reporting could eliminate potential audit inquiries that could otherwise arise if the taxpayers report a higher basis due to step-up on death, for example, in connection with the sale of inherited stock.

We recommend that a similar optional inclusion of Sec. 1043 adjustments (for the sale of property by government officials to comply with conflict rules) could be permitted to be made for basis reporting purposes by brokers and other applicable persons in a manner similar to that regarding gift and death-related basis adjustments. We do not believe such adjustments should be required. We also recommend a revision of Form 8824 to set forth the reduced basis of reinvestment securities on a lot by lot basis and that the taxpayer be required to give a copy of Form 8824 to persons holding those securities.

We recommend that return of capital information should be treated as a corporate action subject to Sec. 6045B reporting in order to provide such information as timely as possible to brokers, that such information should reconcile with amounts reported in Forms 1099-DIV, and that persons responsible for cost basis reporting, including applicable persons in the case of transfers, should be required to use reasonable efforts to reflect return of capital adjustments in the cost basis of stock. In addition the amount of return of capital adjustments should be separately stated. We recommend that brokers be required to take into account capital loss recharacterizations as long-term for regulated investment company ("RIC") and real estate investment trust ("REIT") shares pursuant to Secs. 852(b)(4) and 857(b)(8) but should be permitted to determine holding period based on the acquisition date for the stock. We also recommend that brokers be required to properly account for load charges in accordance with Sec. 852(f) with respect to sales and purchases of front-end load RIC shares. We generally recommend excluding mark-to-market securities and taxpayers from broker cost basis reporting.

When securities are transferred to an account with a U.S. broker from an account with a non-U.S. broker, we recommend that the U.S. broker should request cost basis information from the account holder. If the account holder fails to provide the requested information, the broker would then be required to identify the reason for the omission of cost basis information in the return with respect to a later sale of the securities.

TRANSFER REPORTING:
We recommend that very detailed information (we have included a list of the items that we have identified) should be included in connection with transfer reporting in order for brokers to accurately compute cost basis and required adjustments for corporate actions and wash sales for covered securities.

We believe that brokers should be encouraged to provide cost basis information as soon as possible after securities are transferred (such as by the close of the next business day after the date of the transfer) due to the potential difficulties with reconciling information received later with intervening events and transactions. However, we do not believe such a rule should be mandated until brokers systems are clearly able to meet such a requirement. We also believe that there may be extenuating circumstances that justify

relief from the transfer reporting deadline in certain limited cases. We believe that a different standard of reporting should apply to non-brokers that are subject to Sec. 6045A reporting who do not regularly provide transfer reporting information to brokers.

There should be no general limitation on the lot relief methods available when a customer transfers some but not all securities to another broker. The information should be provided electronically rather than on written or printed statements. Brokers should be able to utilize the reporting services of third-party intermediaries for cost basis transfer reporting purposes without limitation. We believe that in order for Sec. 6045A to work for the transferee, a document should be received from the transferor in all cases, even for noncovered securities.

ISSUER REPORTING:
We recommend that the primary mechanism for issuer reporting should be a public reporting system that relies on the current open network of corporate action reporting services and the delivery to the public of facts and key tax information by issuers, as discussed below. We believe that issuer information should be provided in a format that is detailed enough to permit the necessary corporate action related basis adjustments for covered securities. We recommend that issuers be required to deliver tax disclosure statements or facts regarding the basic tax consequences of a corporate action under a two-tiered approach that relates to the issuer's ability to make a determination under the applicable substantive income tax law. We believe that issuers should not be required to provide precise mathematical computations of adjustments to basis because it would seem to replicate the task of brokers and would be problematic given the differences in facts, valuations and allocations that could apply to different customers of a broker due to their particular circumstances. We also recommend that privately issued specified securities should not be subject to issuer reporting under Sec. 6045B or broker basis reporting under Sec. 6045(g) unless and until the IRS has considered the appropriate rules for both issuers and brokers under the cost basis reporting law. We recommend that the treatment of corporate actions by foreign issuers not subject to Sec. 6045B be treated as a separate project.

The private sector should be encouraged to adopt a uniform protocol for timing the capture of corporate action information with respect to transferred securities. We recommend that a transferring broker identify the date of the last corporate action booked relating to each security transferred to assist the receiving broker in determining whether it has or must make a pending corporate action adjustment to securities received.

BROKER PRACTICES AND PROCEDURES:
We believe a broker must establish procedures that are reasonably calculated to report basis information correctly. We recommend that the IRS establish a reasonable period of time for record retention such as five years rather than indefinite retention. We believe a broker may collect information on non-covered securities for or from a customer, and that such information may be shared with the customer (with a proper disclaimer) and may be, but need not be shared with the IRS. We further recommend that brokers and other applicable persons within the meaning of Sec. 6045A should be permitted to make gift

and death-related basis adjustments (although such adjustments would not be required). We also recommend that the IRS provide for a single account-type election (comparable to that set forth in Sec. 1012(c)(2)(B)) to include pre-effective date securities to all brokers for any security at a broker's election.

A broker may choose to ignore transfer reporting information with respect to a security that is not a covered security. Likewise, a broker may choose to ignore transfer reporting information from a transferor who is not subject to the transfer reporting requirements. We recommend that brokers also be provided two options for such non-covered transferred securities—provide information to customers only or elect to include some or all of any specific non-covered securities in information returns provided to customers and the IRS. We recommend that a broker be required to use reasonable efforts to obtain an issuer report on corporation actions, if it appears that the issuer fails to do so in a timely fashion. To the extent brokers do not receive needed corporate action reports from issuers and must make determinations regarding the effect of such actions on basis on their own, we recommend that brokers should be subject to a lower, good faith standard of care for relief from information return penalties.

We believe that present law penalties should apply to brokers who fail to provide the required information reports. That is, brokers should not be subject to penalties if their failure is due to reasonable cause and not to willful neglect.

Wolters Kluwer Financial Services
Comments in Response to Notice 2009-17

TABLE OF CONTENTS

INTRODUCTION Page 1

EXECUTIVE SUMMARY Page 2

DETAILED RESPONSES TO SPECIFIC COMMENTS Page 11

Applicability of Reporting Requirements

1. How to determine who is a "middleman" subject to the broker reporting and transfer reporting statement requirements and how to minimize duplication of reporting by multiple brokers; Page 11

2. Who, in addition to brokers, should be treated as "applicable persons" subject to the transfer reporting requirements; Page 14

3. Whether the issuer's classification of an instrument (e.g., as stock or debt) should determine which effective date applies; Page 18

Basis Method Elections

4. How to ensure that customers are adequately informed of the broker's default basis determination method and that brokers are adequately notified of a customer's election of a different acceptable method for an account; Page 21

5. How to facilitate customer elections of acceptable basis determination methods, including average cost basis, for an account to maximize customer flexibility and minimize broker burden; Page 23

6. Whether and under what circumstances a customer may elect to change from the average cost basis method to the first-in first-out or specific identification method and, if so, what cost basis rules and adjustments should apply; Page 23

7. What it means to apply the basis determination conventions on an "account-by-account" basis; Page 24

Dividend Reinvestment Plans

8. How to determine what qualifies as an "arrangement under which dividends on any stock are reinvested in stock identical to the stock with respect to which the dividends are paid" (that is, as a "dividend reinvestment plan"); Page 24

9. How to determine which stock qualifies as "acquired in connection with" a dividend reinvestment plan, for which the average cost basis method is available

beginning in 2011, and to which the later effective date of 2012 for information reporting applies; Page 25

10. Whether and to what extent the average cost basis method applies to subsequent additions to dividend reinvestment plan accounts by purchase or transfer; Page 26

11. How to maximize the utility of the single-account election for stock acquired in connection with a dividend reinvestment plan or stock held in a regulated investment company, particularly where basis and holding period information for pre-effective date stock is weak or unclear; Page 27

Reconciliation with Customer Reporting

12. How to ensure that broker reporting on Form 1099-B and customer reporting on Schedule D of Form 1040 are maximally consistent, including whether brokers should report separately for securities subject to basis reporting or report the basis of securities that are not covered securities, for example, securities purchased by their customers prior to 2011; Page 28

13. How to ensure consistency between customers making specific identification of securities sold or transferred and broker reporting; Page 30

14. How to ensure that reconciliation is possible if broker reporting should differ from customer reporting; Page 31

15. Whether customers, after a sale, may identify or change the identification of specific stock sold and, if so, for what period of time or by what deadline; Page 32

Special Rules and Mechanical Issues

16. The scope of the wash sales exception, including the definition of "identical securities" (including identical options), the wash-sale period, and any de minimis or other exceptions; Page 33

17. How to apply the rules for basis reporting of options; Page 34

18. Whether rules, including transition rules, are required to address the change in timing for reporting of short sales from the date the short sale is entered into to the date the short sale closes; Page 35

19. How to address mechanical issues relating to the computation of basis, such as adjustments for debt securities (for example, as a result of original issue discount, market discount, acquisition premium, or bond premium), gift-related adjustments, death-related adjustments, section 1043 basis rollovers, regulated investment company and real estate

investment trust distributions representing return of capital, regulated investment company load adjustments, and the mark-to-market method of accounting for securities; Page 37

20. What, if any, translation conventions or computation adjustments should be allowed when securities are purchased with foreign currency in an account subject to United States taxation at the time of purchase or in an account that later becomes subject to United States taxation, for example, when an owner of securities becomes a United States citizen; Page 46

Transfer Reporting

21. What information about the transferring person, the customer, the security transferred, and the underlying lots should be required on the transfer reporting statements; Page 48

22. Whether fifteen days is the proper period for furnishing transfer reporting statements, and under what circumstances a different time period, if any, should apply; Page 51

23. Whether the basis determination rules and customer elections governing sales of securities should apply equally to transfers of securities, for example, when a customer transfers some, but not all, holdings of a security to another broker; Page 53

24. Whether electronic transfer reporting may be appropriate and, if so, whether a common format should apply; Page 53

25. Whether brokers and transferring parties may utilize reporting services of third-party intermediaries to meet their transfer reporting requirements; Page 54

26. Whether the transferring person should communicate any information or justification to the transferee broker when no transfer reporting statement is required because the security is not a covered security; Page 54

Issuer Reporting

27. What information about the issuer and organizational action should be required on the issuer returns and reporting statements; Page 55

28. How to maximize the timeliness of issuer returns and statements and promote public reporting by issuers in lieu of return filing; Page 61

29. How to account for basis-changing organizational actions by foreign issuers of securities to the extent that foreign issuers are not subject to the issuer reporting requirements; Page 63

30. How to coordinate broker transfer reporting with issuer corporate action reporting to avoid duplicate broker adjustments when accounts are transferred and whether a universal timing standard should apply; Page 64

Broker Practices and Procedures

31. To what extent a broker should verify the reasonableness of basis information and what document retention requirements should apply; Page 65

32. What procedures a broker should follow if the broker derives basis and holding period information for or from customers with respect to a security that is not a covered security, including potential reporting of such information to either the customer or the Service; Page 65

33. What procedures a transferee broker should follow if the broker does not receive a transfer reporting statement; Page 66

34. What procedures a transferee broker should follow if the broker receives transfer reporting information with respect to a security that is not a covered security, or from a transferor who is not subject to the transfer reporting requirements; Page 67

35. What procedures a broker should follow with respect to basis adjustments if an issuer report on a corporate action is insufficient or untimely; Page 68

36. Under what circumstances penalties may apply to brokers or other reporting entities and when relief from penalties should be available. Page 69

DETAILED RESPONSES TO SPECIFIC COMMENTS REQUESTED:

Applicability of Reporting Requirements

1. How to determine who is a "middleman" subject to the broker reporting and transfer reporting statement requirements and how to minimize duplication of reporting by multiple brokers;

Under Secs. 6045(g) and 6045A, the new broker cost basis reporting requirement applies to brokers subject to gross proceeds reporting obligations under current law (i.e. to brokers as defined in Sec. 6045(c)1)), while the transfer information statement requirement applies to "applicable persons" defined as meaning any broker and any other person as provided in regulations. We use the term "applicable person" to refer to those other persons and the term "broker" to refer to brokers as defined in Sec. 6045(c)(1).

RECOMMENDATION:
We recommend that the determination of persons subject to cost basis reporting requirements be based principally on the definition of broker in the current regulations. However, certain exemptions from the gross proceeds reporting requirement should be reviewed and possibly modified. In addition, we recommend that the term "applicable persons" be broadly construed to include persons who have cost basis information in certain situations. Finally, the rules should include a broad provision respecting multiple reporting obligations to minimize duplication of reporting.

DISCUSSION:
1. Definition of broker; inclusion of middlemen. We believe that is important to begin by considering the existing law definition of broker for gross proceeds reporting purposes. Sec. 6045(c)(1)(C) defines the term broker to include "any other person who (for a consideration) regularly acts as a middleman with respect to property or services." The restrictive effect of the "regularly" requirement is reflected in the Sec. 6045 regulations. Treas. Reg. 1.6045-1(a)(1) defines the term broker generally to mean a person that "stands ready to effect sales to be made by others." The regulation goes on to include "an obligor that regularly issues and retires its own debt obligations or a corporation that regularly redeems its own stock." Moreover, the Sec. 6045 regulations also include examples to illustrate when persons other than broker-dealers may be considered "brokers" for purposes of gross proceeds reporting. In general, custodians, escrow agents and stock transfer agents may be "brokers," provided they carry on their activities regularly and the nature of the activities is such that they would ordinarily know the gross proceeds from sales. See Treas. Reg. 1.6045-1(b), Examples 1 & 2.

We make two general observations about the foregoing definition of broker. First, the focus in defining "broker" for purposes of the gross proceeds reporting requirements is to identify persons who have information about the amount of gross proceeds. For cost basis reporting, the objective is to identify persons who have information about cost basis. In most cases, the same person will have information about both cost basis and

gross proceeds. But in some situations the parties with the relevant information may not be the same. See the employer/broker example below. An appropriate approach here may be to impose conjoint reporting obligations but provide for delegation and cooperation among the parties so that duplicate reporting is avoided.

Second, in some cases the persons having cost basis information may not be "middlemen" described in Sec. 6045(c)(1)(C) because they do not regularly act as middlemen. Consideration should be given to a broad definition of "applicable persons" under Sec. 6045A to cover many of those cases. This is discussed further in the response to Notice Issue No. 2.

2. Stock acquired pursuant to restricted stock plans, employee stock options, and employee stock purchase plans. Stock subject to gross proceeds reporting is predominantly acquired through brokerage accounts in transactions effected on stock exchanges. The broker responsible for gross proceeds reporting will generally also have cost basis information. But stock can also be acquired under employee stock or company offered dividend reinvestment plans and then transferred to a brokerage account. In these cases, the person having gross proceeds information may not have cost basis information. While the gross proceeds definition of "broker" contains provisions broadening the definition of broker to cover certain agents of corporations, an extension of the definition may be needed for purposes of cost basis reporting.

Treas. Reg. 1.6045-1(b), Example (1)(iv) and (v) states that the following persons, among others, generally are brokers:

- a stock transfer agent for a corporation, which agent records transfers of stock in such corporation, if the nature of the activities is such that the agent ordinarily would know the gross proceeds from sales, and
- a dividend reinvestment agent for a corporation that stands ready to purchase or redeem shares.

A significant element of the description of stock transfer agents who are brokers is that they ordinarily would know the gross proceeds from sales.

Employees may receive stock in an employer corporation that is restricted stock, that is acquired pursuant to a qualified or nonqualified stock option, or that is acquired pursuant to a Sec. 423 employee stock purchase plan. If stock acquired through exercise of an option is immediately sold, the transaction may give rise entirely to compensation income and be exempt from gross proceeds reporting. See Rev. Proc. 2002-50, 2002-2 CB 173. We understand that this situation is quite common today given the effect on qualified stock options (which may otherwise result in capital gains for the employee) of the alternative minimum tax. In other cases, however, the employee may retain some or all of the stock acquired through exercise of an option.

A stock transfer agent for the corporation would not necessarily be a broker under the current definition because it would not ordinarily know the gross proceeds from eventual

sales. And the transferee broker would not have cost basis information in the ordinary course. To ensure that the parties would need to combine their knowledge so as to report both cost basis and gross proceeds information, the regulations could be amended to make the stock transfer agent a "broker" if it regularly transfers shares. Or it could be made an applicable person subject to an obligation under Sec. 6045A to furnish cost basis information to the transferee broker.

A similar analysis may apply to restricted stock, which typically may not be transferred to a brokerage account until the stock has vested.

3. Corporate liquidations. Existing rules coordinate reporting requirements under Sec. 6045 and 6043 (information reporting for corporate liquidations). As discussed below, the method chosen to coordinate those rules might result in inadequate reporting of basis related information. Accordingly, the resolution of the interaction of those provisions effected by existing rules should be reviewed in light of the objectives of the cost basis reporting requirements.

Sec. 6043(a)(2) requires a liquidating corporation to make a return with respect to distributions in liquidation. Treas. Reg. 1.6043-2(a) requires information returns on Forms 1096 and 1099. Currently, the return for shareholders is Form 1099-Div, boxes 8 and 9. Returns made under Sec. 6043 would not include cost basis information. Treas. Reg. 1.6045-1(a)(1) excludes a person required to report a transaction under Sec. 6043 from the definition of a "broker." It is not clear whether that exclusion applies to a person who would otherwise be a broker (e.g. an open-end regulated investment company that regularly redeems its own stock) so as to operate as a transactional exemption for liquidations subject to Sec. 6043 reporting.

If stock in a liquidating corporation is held in a brokerage account, it may not be necessary for the liquidating corporation to have cost basis reporting obligations. The corporation would report liquidating distributions as under current law, and the broker on the account would supply the cost basis reporting. Indeed, in such a case the corporation likely would not have access to cost basis information. However, it may be necessary to make clear that the existence of a Sec. 6043 reporting requirement for the corporation does not eliminate cost basis reporting for the broker. And a system in which the corporation makes an information return with respect to the liquidation and the broker makes a Sec. 6045 return covering both gross proceeds and cost basis would likely result in duplicative reporting. So the better way to coordinate the provisions may be to exclude information reporting under Sec. 6043 if the broker has the gross proceeds information.

In addition, the current exclusion of liquidating corporations from gross proceeds reporting could result in an absence of cost basis reporting for many corporate liquidations if the corporation itself maintains shareholder accounts (and does not regularly redeem its own shares) even though the corporation may have access to cost basis information in that case. This would most likely be the case of a private corporation (an issuer of stock that is not publicly traded). But it is also not clear in these

cases whether the liquidating corporation could be brought into the Sec. 6045 definition of a broker, because it may not be considered "regularly" to act as a middleman as envisaged by the definition in Sec. 6045(c)(1)(C).

The potential gap in cost basis reporting with respect to liquidations is most likely a limited case, and, therefore, a low priority issue, as it generally affects only liquidations of private corporations (since stock of public corporations will generally be traded on an exchange in transactions affected through brokers). Nevertheless, we recommend that consideration be given to (1) a technical amendment authorizing regulations dealing with the situation and (2) a revision of the definition of broker to make clear that an open-end investment company (or any other corporation that regularly redeems its own shares) is a broker with respect to liquidating distributions as well as redemptions.

4. Exempt recipients. The current gross proceeds reporting requirement operates on "sales." A "broker" is required to make a gross proceeds information return with respect to sales made by a "customer of the broker," Treas. Reg. 1.6045-1(c)(2), other than a sale effected for a customer that is an "exempt recipient," Treas. Reg.1.6045-2(c)(3)(i)(A). One initial question is whether the cost basis reporting rules should have a similar list of exempt persons for which cost basis reporting will not be required. This question should be resolved at an early date, as brokers need to be able to identify those cases for which they must capture and maintain cost basis information.

A related question is whether the transfer rules should apply to transfers of accounts of entities that are exempt recipients under the current rules.

5. Elimination of duplication in reporting. A narrow definition of broker for cost basis reporting purposes could run the risk of gaps in reporting. A broad definition of broker could result in several different persons being treated as brokers for the same transaction. Such a definition could potentially result in duplicate reporting of the same transaction. One possible model for avoiding duplication in reporting is provided in Treas. Reg. 1.6050P-1(e)(2), which generally creates the potential for multiple reporting obligations and then excuses persons with a co-reporting obligation if the obligation is satisfied by another.

2. Who, in addition to brokers, should be treated as "applicable persons" subject to the transfer reporting requirements;

RECOMMENDATION:
We recommend that the term "applicable person" be broadly applied as a means of minimizing gaps in the cost basis reporting regime. However, imposing cost basis reporting obligations on persons who are not regularly subject to information reporting could be unduly burdensome. Accordingly, "applicable persons" should be limited to persons who regularly acquire cost basis information in the course of their business. For example, a rule requiring administrators or executors to provide cost basis information should be limited to professional administrators and executors such as banks and trustees.

DISCUSSION:

1. Preliminary observations. At the outset, we examine certain questions we have identified in the interpretation of Sec. 6045A. In particular, although we understand that the provision was intended mainly to apply to transfers of securities from one broker to another, we note that important issues can be presented by transfers from one account to another at the same broker.

As an initial observation, we note that the basic operative provision of cost basis reporting under the transfer rule of Sec. 6045A applies to "every applicable person who transfers to a broker . . . ." Under Sec. 6045A(b)(1), a broker is an applicable person. So one question is whether Sec. 6045A applies to a transfer from one account at a particular broker to another account at the same broker. This could affect the classification of transferred securities as "covered securities." Suppose, for example, that the transfer is from an account of individual A to a joint account of individual A and individual B and that the transferred securities includes securities that were covered securities in the first account. For purposes of determining whether the transferred securities are "covered securities" in the second account, is this a case described in Sec. 6045(g)(3)(A)(i) (acquired through a transaction in the new account) or a case described in Sec. 6045(g)(3)(A)(ii) (transfer to an account from an account in which the securities were covered securities)? If the latter, the securities would arguably lose their status as covered securities unless the broker receives a statement under Sec. 6045A with respect to the transfer, which obviously would be a statement from the broker to itself and seem to be an unnecessary requirement. Perhaps the common sense answer is that Sec. 6045A does not apply but the change in account is disregarded in determining the status of securities as covered securities. But it may be necessary to say so explicitly. Moreover, as pointed out in the following discussion, some intra-broker changes in accounts could result in a change in cost basis and could present situations to which Sec. 6045A should apply.

More broadly, we are concerned about situations in which a broker may receive, or arguably should receive, cost basis information from persons who are not brokers as defined in Sec. 6045(c)(1). But while we identify situations in which treating additional persons as "applicable persons" could make the cost basis reporting system more comprehensive, we understand that, on balance, administrative burden considerations may dictate that some gaps in the reporting system are acceptable in the initial implementation phase and, accordingly, recommend that "applicable persons" be limited to persons who regularly acquire cost basis information in the course of their business. We also discuss situations in which brokers receive cost basis information from others who are not required to provide that information.

2. Sale transactions. We understand that in general Sec. 6045A is intended to require a transfer of cost basis and related information when securities are transferred from one brokerage account to another without a contemporaneous sale transaction. However, Sec. 6045A may also apply to transfers of securities in connection with a sale. For example, a

corporation may transfer securities acquired by an employee to a broker contemporaneous with the employee's sale of the securities.

3. Transfers of securities "acquired from a decedent" within the meaning of Sec. 1014(b). Sec. 1014(b) provides special rules for the cost basis of "property acquired from a decedent." In general, the cost basis is the fair market value of the property at the date of the decedent's death or upon an alternative valuation date. This "stepped up basis" rule needs to be taken into account regardless of whether a decision is made to exercise the authority to treat additional persons as "applicable persons" under Sec. 6045A.

For example, upon the death of an accountholder, securities in an account will frequently have to be transferred to a new account opened in the name of the administrator or executor. The new account could be with a different broker. Under present practices, the new broker, but not the old broker, may have received documentation regarding the date of death and the capacity of the person opening the account. The transferred securities could include securities acquired after the date of death as well as those held on the date of death. This simple case can present some difficult processing issues.

One approach would focus principally on information to be required under Sec. 6045A in connection with a broker to broker transfer. The rules might require additional information when the transfer is to an account identified as an administrator or executor account and might envisage that the transferor broker would request date of death information from the administrator/executor when a transfer request is received. The transfer information would then include whether the securities were acquired before or after the date of death. However, the time that might expire between the date of death and the transfer request could exceed the long-term holding period. In that case, the rule would either excuse the transferor broker from classifying particular securities as acquired before the date of death or would have the practical effect of requiring brokers to retain acquisition date information for a period longer than the long-term holding period. This approach has a limited benefit in any event as it serves only to identify cases in which historic cost basis information is incorrect.

A second approach would make the executor or administrator an "applicable person." A narrow application of that approach would require the executor or administrator to provide cost basis information in connection with a sale. One might ask why that would be useful given that the information would then be reported back to the executor or administrator together with the gross proceeds of the sale. But it would limit cases in which returns filed with the IRS would show no cost basis information and possibly trigger processing protocols at service centers. A more global approach would be to require executors or administrators to provide cost basis information to brokers generally. The requirement could include a certification that the value provided are those used for estate or inheritance tax purposes, if an estate or inheritance tax return is required. For further discussion, see our comments regarding Notice Issue No. 19

We also note that a broker to broker transfer can occur prior to the time the estate tax value has been determined (e.g. between the date of death and the alternative valuation

date). This is a reason why the best approach may be to provide for identifying broker to broker transfers that may be affected by the stepped up basis rule but to rely on information provided by the administrator/executor to update the cost basis information.

Finally, another broker to broker transfer potentially affected by the stepped up basis rule could occur when securities are distributed to legatees or heirs through a transfer from the account of the administrator or executor to an account of the legatee or heir.

4. Lifetime gifts. Lifetime gifts can affect cost basis in two ways. First, the transferee's cost basis is generally the donor's cost basis, except that the basis for purposes of determining loss is limited to fair market value. The regulations provide that fair market value is the value used for federal gift tax purposes or, if not subject to federal gift tax, State gift tax purposes. The gift tax regulations provide that for publicly traded stocks and bonds the fair market value is the mean between the high and low prices for the day of the gift.

Suppose that on July 15, 2011, A owns 1000 shares of X corporation stock acquired in 2008 and directs a broker to transfer 100 shares to the account of a son with the same broker. One question is whether the facts describe an acquisition "through a transaction in the account of the son" causing the 100 shares to be covered securities or whether the facts simply describe a transfer to the son's account of shares that are not covered securities.

If the facts are changed so that the 100 gift shares are clearly covered securities, then the question is whether A needs to be an "applicable person." In principle, the broker will know A's cost basis. But A's cost basis will not be the son's cost basis if the transfer is not a gift transfer (for example, if A is transferring the stock as payment for services rendered or in connection with an off-exchange sale). So consideration should be given to making A an "applicable person" for purposes of requiring A to disclose whether the transfer is a gift transfer.

A further question is presented by the rule limiting basis to fair market value for purposes of determining loss. For traded stocks and bonds, it may be that the fair market value information need not be captured at the time of the transfer if the position is adequately coded as a position acquired through gift and the date of the gift (which need not necessarily be the same as the date of the transfer) is identified. If the security is later sold at a loss (determined using the donor's cost basis), the broker's program would then access a database containing the date of gift market price information necessary to apply the loss basis limitation.

Further complications can arise when stock or bonds are transferred from an account in the name of one person individually to a joint account for that person and another. In general, no gift occurs until the other person withdraws the transferred stock or bonds or the proceeds of their sale. In this case, the fair market value limitation would be the sale at the time the gift is completed through the withdrawal.

The second way in which lifetime gifts can affect cost basis arises through the adjustment provided in Sec. 1015(d) for gift tax paid. The cost basis is increased, but not above fair market value at the time of the gift. Consideration should be given to providing that any donor seeking to provide the benefit of this basis adjustment for a gift would be an "applicable person" and would be required to provide the basis adjustment information to the broker for the donee. The time for providing the cost basis adjustment information could be coordinated with the time for filing the quarterly gift tax return.

For additional discussion regarding basis reporting relating to gifts, see our comments in response to Notice Issue No. 19.

3. Whether the issuer's classification of an instrument (e.g., as stock or debt) should determine which effective date applies;

RECOMMENDATION
We recommend that the issuer's classification should control except in exceptional circumstances. We recommend that the IRS exclude from cost basis reporting and not treat as covered securities hybrid instruments or units that are not classified by the issuer for tax purposes as a single equity or debt instrument unless and until explicit guidance is issued regarding their treatment for cost basis reporting purposes.

DISCUSSION:
Section 385(c) provides as follows:

> (c) Effect of classification by issuer.
>
> (1) In general. The characterization (as of the time of issuance) by the issuer as to whether an interest in a corporation is stock or indebtedness shall be binding on such issuer and on all holders of such interest (but shall not be binding on the Secretary).
>
> (2) Notification of inconsistent treatment. Except as provided in regulations, paragraph (1) shall not apply to any holder of an interest if such holder on his return discloses that he is treating such interest in a manner inconsistent with the characterization referred to in paragraph (1).
>
> (3) Regulations. The Secretary is authorized to require such information as the Secretary determines to be necessary to carry out the provisions of this subsection.

The threshold question is whether an issuer's classification ought to control for purposes of the effective date of the new cost basis reporting legislation. As pointed out in the Notice, the applicable effective date for acquired stock is generally January 1, 2011, while the applicable effective date for acquired debt is January 1, 2013, or such later date as specified by the Secretary. It is generally expected that later dates will apply to financial instruments to which Treasury and IRS extend the application of the cost basis reporting rules pursuant to the authority in Sec. 6045(g)(3)(B)(iii) & (iv). For example, the tax treatment of exchange traded notes, which may be neither debt nor equity, is currently under review. The effective date of any information reporting regime for those

financial instruments may be determined in connection with future guidance on their tax treatment. The comments below address only issuer determinations with respect to the classification of an instrument as debt or equity.

With respect specifically to the question posed, the effect of the issuer classification on the applicable effective date, we submit that it is essential for brokers and other reporting entities to be able at the earliest possible time to begin sorting securities into "buckets" reflecting the different effective dates. It is unclear whether security identifying codes such as CUSIP will fully address sorting concerns, particularly given that such codes are not universal for all security types and may not precisely address the tax characterization of covered securities for basis reporting purposes. We believe that respecting the issuer's classification represents the most practical approach administratively and is consistent with the default rule in Sec. 385(c).

We also discuss other respects in which classification may affect substantive reporting requirements and recommend that middlemen should be required to respect the issuer's classification except in exceptional circumstances.

The broker's potential status as a holder for this purpose must be considered. Typically, it would seem that a broker would be a middleman holding as a nominee for its customer (the beneficial owner of the security). A middleman may be a "holder" for purposes of this provision, because as discussed below the classification of a security may also affect a middleman's withholding tax or information reporting obligations under other provisions.

While we recommend that the issuer's classification should control for purposes of determining the applicable effective date, we believe a more difficult question is whether the issuer's classification should control for purposes of determining the substantive obligations of a middleman. This issue can arise in a variety of circumstances, some of which are likely beyond the scope of the guidance project for implementing the cost basis reporting provisions. However, the drafters may need to take into account the potential implications for those other circumstances of the approach taken to the conclusiveness of an issuer's classification for purposes of Sec. 6045(g).

For example, the classification of an instrument as debt or stock may affect the application of withholding tax provisions (when the beneficial owner of the instrument is a foreign person) or information reporting (when the beneficial owner of the instrument is a U.S person). Interest on debt may be portfolio interest exempt from withholding tax under Sec. 1441(c)(9), while dividends on stock are subject to withholding tax unless totally exempted by treaty. Similarly, Sec. 6041 requires information reporting for payments of interest of $600 or more, while the aggregate reporting threshold for dividends under Sec. 6042 is $10.

While the classification of an instrument as debt or equity may affect the obligations of a middleman, the more significant ultimate consequences are those affecting the beneficial owner.

Accordingly, we make the following recommendations. First, a middleman should be treated as a "holder" for purposes of Sec. 385(c) and would be required to follow the issuer's classification of an instrument as debt or equity. Consideration could be given to permitting a middleman to depart from that classification under the provisions of Sec. 385(c)(2). But we anticipate that such departure would be permitted only if notice of the inconsistent position is given to the beneficial owner and that issues would then arise regarding the effect to be given to a decision by the beneficial owner to respect the issuer's classification. On balance, we conclude that middlemen should be required to respect the issuer's classification except in exceptional circumstances.

Second, we note that under the statute a beneficial owner may decline to follow an issuer's classification subject to notification as provided in Sec. 385(c)(2) and that regulations are authorized to impose additional rules respecting the exercise of that right to take an inconsistent position. Consideration could be given to requiring the beneficial owner to notify a middleman that an inconsistent position is being taken so that the middleman may put the instrument in the right "bucket" for purposes of applying substantive rules affecting cost basis (such as accrual of original issue discount ("OID")). If that is done, the rule should require that the notice be given within a relative short period (e.g. 30 days) after the acquisition of the instrument, so as to minimize retroactive recalculation of basis adjustments. To the extent notice is required, we recommend that such notice be permitted to be provided electronically to expedite broker/middleman processing. In cases when the middleman, following the suggested procedure, is not following the issuer's classification, it may be necessary to provide an opportunity for a middleman on its return to the IRS to identify that it has followed a beneficial owner's classification rather than the issuer's classification.

Third, we recommend that unless regulations provide beneficial owners with an inconsistent notice procedure and the notice is properly provided within the specified time period, a middleman should be permitted to rely on the issuer's classification.

Fourth, consideration could be given to authorizing middlemen generally to depart from an issuer's classification at the request of a beneficial owner who represents that it is exercising its right under Sec. 385(c)(2) to take an inconsistent position. Middlemen should not be required to follow the request but should be able to rely on the request, subject to provisions for providing notice to the IRS.

Finally, we note that certain investments consisting of a combination of securities are traded as an investment unit and tracked by many brokerage systems as a single investment, although for tax purposes the components may be treated as separate securities and may include a covered security (such as stock or debt). An example would be certain Canadian income trusts interests that represent the combination of debt and stock of a single issuer.[1] The trust interests may have one CUSIP number, with separate CUSIP numbers for the stock and the debt that are used only if the stock and debt are withdrawn from the trust and separately held or traded. Other investment units may

[1] A similar combination, Income Deposit Securities, has been issued in the U.S.

consist of a combination of stock and an option on that stock. Treated as a unit, it is not clear that these instruments are covered securities. They would be covered securities when separated, and the regulations might contain a rule requiring that the broker allocate the unit basis among the components at the time of the separation based on values when acquired. See Treas. Reg. 1.1012-1(d). We recommend that the IRS issue guidance regarding whether and to what extent such units should be treated as covered securities.

Basis Method Elections

4. How to ensure that customers are adequately informed of the broker's default basis determination method and that brokers are adequately notified of a customer's election of a different acceptable method for an account;

RECOMMENDATION:
Customers should use current procedures to specify stock to be sold by their broker. That is, customers may specify the particular stock to be sold at the time of sale (or before, pursuant to a standing order), and their brokers should confirm that specification in a written document within a reasonable time thereafter. Otherwise, FIFO would be appropriate to determine the basis of the stock that was sold. For mutual fund shares (and DRIP stock eligible for average cost basis) in accounts established before January 1, 2012, customers should select a basis methodology and, if they fail to do so, their broker should select a method for them. For mutual fund shares (and eligible DRIP stock) in accounts that are opened on or after January 1, 2012, customers should select a basis methodology at the time they open the account, and their broker should disclose the default selection, if they fail to choose one.

DISCUSSION:
Sec. 6045(g)(2)(B)(i) generally requires a broker to use a first-in/first-out (" FIFO") methodology to report the basis of securities (other than stock for which an average cost is permitted), unless the customer requests another methodology for the security at the time of sale (e.g., specific identification or specific ID)). For stock for which an average cost is permitted, the broker generally chooses the methodology (e.g., average cost, single-category, average cost, double-category, FIFO, or specific ID) for the account in which the stock is held, unless the customer notifies the broker that he elects another methodology with respect to the account.

Treas. Reg. 1.1012-1(c)(3) sets forth the procedures for specific ID and requires both identification by the customer and the subsequent delivery of a confirmation identifying the shares sold by the broker to the customer. In Priv. Ltr. Rul. 9728021, dated April 10, 1997, the IRS concluded that the entry of a standing order by a customer with a broker to sell specific lots of stock using a methodology under specific ID known as "highest-in/first-out" ("HIFO") and the delivery of confirmations subsequent to each sale by the broker to the customer qualified as a permitted method of lot relief under Treas. Reg. 1.1012-1(c)(3). This standing order methodology creates processing efficiency and saves brokers and customers time and money.

We believe a customer should request a methodology other than FIFO to report the basis of stock that is not eligible for average cost reporting at the time of sale (and, if customer selects specific ID, the particular stock to be sold). Within a reasonable time thereafter, the broker should confirm the specification in a written document from the broker. We recommend that such confirmation should be part of the broker's sale confirmation and should be permitted to be provided electronically for Treas. Reg.1.1012-1(c)(3) purposes if so permitted for securities regulatory and industry standards purposes. This rule generally follows the present-law specific identification procedure in Treas. Reg. 1.1012-1(c)(3).

For a methodology with respect to stock for which an average cost is permitted, we believe the customer should similarly request a methodology at the time the customer opens the account, and the choices should be presented to the customer expressly. We recommend that the customer should be provided a reasonable period to make such election. We are uncertain how long this period should be—such as two weeks, a month or some other period. Regardless of the period selected, we then considered whether there might be circumstances where a customer could later elect out (revoke his original election). That would also need to be considered. For example, a customer's tax or financial advisor might later advise him that he should have made the election or selected a different lot relief method.

As a systems matter, we believe that the period should generally end no later than the soonest of (1) actual sales of the securities to which the lot relief method applies; (2) the end of the calendar year (the tax reporting period); or (3) one year from the date the securities subject to the lot relief method selection are first purchased. The rationale for permitting a period of up to one year from the date the securities are purchased could be that even under the average cost lot relief methods, the broker or taxpayer must retain information regarding the holding period of all short-term lots in order to properly determine whether any gains or losses are long-term or short-term. However, we note that the burdens of such an approach would need to be weighed against the potential benefits of increased customer flexibility.

Regardless of the lot relief method selected and who makes such selection (the customer or the broker), we believe that: the broker should electronically notify the customer at the time the selection is made (or elected); designate the method selected on the Form 1099; and the customer should designate the method selected on Schedule D (or D-1) to promote consistent treatment and to facilitate IRS audit or review of broker and customer compliance for lot relief methods and related basis determinations.

5. How to facilitate customer elections of acceptable basis determination methods, including average cost basis, for an account to maximize customer flexibility and minimize broker burden;

RECOMMENDATION:
As discussed above in response to Notice Issue No. 4, taxpayers should follow current procedures to determine cost basis, which should provide adequate flexibility.

DISCUSSION:
We believe current procedures afford customers adequate flexibility. Customers may continue to identify the specific stock that is being sold at the time of sale. For stock that is eligible to be reported on an average cost methodology, the customer should be allowed to select a methodology at the time an account is opened, and then will continue to receive reports based on this methodology. For accounts that are opened before January 1, 2012, customers should select a basis methodology and, if they fail to do so, their broker should select a method for them.

6. Whether and under what circumstances a customer may elect to change from the average cost basis method to the first-in first-out or specific identification method and, if so, what cost basis rules and adjustments should apply;

RECOMMENDATION:
Once average cost basis method is selected (either by the customer or, by default, the broker), the method should continue to be used for information reporting purposes.

DISCUSSION:
For stock that is eligible for average cost reporting, we believe a customer should generally stick to the method selected at the time the account is opened (subject to the right to elect out as describe above in response to Notice Issue No. 4). A broker that maintained average cost on a rolling basis may not be able to determine tax lot information details necessary to apply FIFO or specific ID for stock that is more than a year old.

The IRS could readily accommodate customers' desire to change accounting methods (and potential election-out limitations) by explicitly providing that customers could open a new account (i.e., self help), if they want to account for newly acquired securities differently than previously acquired securities. The justification would be that the basis rules of Sec. 1012 under the new cost basis reporting law are applied on an account-by-account basis. We also note that broker cost basis reporting rules are information return rules for brokers and are generally not substantive income tax rules relating to the computations of gains and losses from securities transactions for a broker's customers. Given this, we believe that customers also may calculate their tax liability on their income tax return with a basis methodology that differs from the one that had been provided to them (e.g., a customer could use first-in, first-first out, and ignore an average cost report to them). Customers should disclose the difference on their return. See Notice Issue Nos. 12-14.

7. What it means to apply the basis determination conventions on an "account-by-account" basis;

RECOMMENDATION:
A broker should calculate basis separately for stock in each customer account, even if the identical stock is held in the account of the same (or a related) customer. As a result, a broker should calculate wash sales, average cost basis, etc. separately for each account.

DISCUSSION:
The new cost basis reporting legislation provides that brokers may calculate adjusted basis without regard to the wash sale rules unless the transactions occur in the same account with respect to identical securities. Sec. 6045(g)(2)(B)(ii). Similarly, the new legislation requires "in the case of the sale, exchange, or other disposition of [securities], the conventions prescribed by regulations under [section 1012] shall be applied on an account by account basis." Sec. 1012(c)(1). We believe Congress intended brokers to calculate basis (e.g., with a first-in, first-out, specific identification, or average cost methodology), by reference only to securities within a single account, without reference to securities in other accounts of that customer that are maintained by the broker or by any other person. We believe that this was done to address processing concerns and limitations that could arise if transactions in different accounts were analyzed in the aggregate.

Dividend Reinvestment Plans

8. How to determine what qualifies as an "arrangement under which dividends on any stock are reinvested in stock identical to the stock with respect to which the dividends are paid" (that is, as a "dividend reinvestment plan");

RECOMMENDATION:
The IRS should clarify that both issuer sponsored or offered dividend reinvestment plans (including those administered by transfer agents or other third parties) and broker offered dividend reinvestment plans constitute dividend reinvestment plans within the meaning of Sec. 1012(d)(4)(A). We recommend that stock be treated as DRIP stock only for the customer that has elected to participate in a DRIP plan. We believe that only stock that is paying dividends at the time the issuer or other person begins offering the plan qualifies as DRIP stock. We note, however, that company sponsored plans incur costs for such plans that could justify broader treatment for such plans.

DISCUSSION:
Sec. 1012(d)(4)(A) defines a "dividend reinvestment plan" for purposes of eligibility for averaging of cost basis of shares for lot relief purposes. As referenced in the Notice, this definition includes "...any arrangement under which dividends on any stock are reinvested in stock identical to the stock with respect to which the dividends are paid." Note the language "any arrangement." Thus, the definition would not appear limited to

dividend reinvestment plans offered by the issuer of the stock (or a stock transfer agent on the issuer's behalf). It presumably also includes dividend reinvestment plans offered by transfer agents or other third parties.

It must also be considered whether non-dividend paying stock can be part of a dividend reinvestment plan within the meaning of Sec 1012(d)(4)(A). The statutory reference to "...under which dividends on any stock are reinvested..." could be interpreted as excluding any stock purchase plan relating to non-dividend paying stock from the definition of a dividend reinvestment plan. However, a company can generally begin or discontinue the payment of dividends on its stock as it chooses. Thus, it is necessary to consider the impact of the termination of dividend payments on stock as it relates to stock included in (or excluded from) an averaging pool for basis calculation purposes under Sec. 1012. Similarly, if a company begins paying dividends on its stock sometime after it was issued and a dividend reinvestment plan is offered, it must be considered whether previously acquired shares are included in the averaging pool (this question is also discussed below in connection with the scope of Sec. 1012(d)(4)(B)). For simplicity, we recommend that only stock that is paying dividends at the time the issuer or other person begins offering the plan qualifies as DRIP stock (without regard to whether dividends subsequently cease).

9. How to determine which stock qualifies as "acquired in connection with" a dividend reinvestment plan, for which the average cost basis method is available beginning in 2011, and to which the later effective date of 2012 for information reporting applies;

RECOMMENDATION:
We recommend that stock be treated as DRIP stock eligible for averaging only for the shares held by the customer (the original shares in the plan on which dividends are paid and the shares acquired through dividend reinvestment) that are included in the DRIP plan.

DISCUSSION:
A related issue relates to the meaning of the phrases "in connection with a dividend reinvestment plan..." and "while held as part of such plan..." in Sec. 1012(d)(1). It should be determined whether averaging is only available to those holders of stock that elect to participate in a dividend reinvestment plan or whether averaging is available to holders of stock for which a dividend reinvestment plan is offered (without regard to whether a holder elects to participate in such plan). We recommend that the phrase be limited to include only those holders that actually elect to participate in a dividend reinvestment plan. We note that it could be argued that such a limitation would make the programming of broker basis reporting systems more difficult because such systems would need to determine or confirm participation in dividend reinvestment plans on a customer by customer basis. However, we believe that the referenced language is controlling.

10. Whether and to what extent the average cost basis method applies to subsequent additions to dividend reinvestment plan accounts by purchase or transfer;

RECOMMENDATION:
Yes, the average cost basis method should apply to subsequent additions. If additional shares are eligible for averaging, brokers and taxpayers should be permitted to maintain a single averaging pool for all post-effective date identical shares. The IRS should also consider whether other identical shares held by a taxpayer that are purchased or transferred must be excluded from the averaging pool and consider the potential burden to brokers and taxpayers of excluding such shares. The IRS should also clarify the treatment for averaging purposes of shares acquired before a dividend reinvestment plan is offered as well as those acquired after a dividend reinvestment plan is terminated or suspended. The IRS should also clarify the treatment of transferred shares from a broker or agent that offers a dividend reinvestment plan to one that does not (and vice versa).

DISCUSSION:
It must be considered whether the averaging pool only includes original acquisition shares and related dividends or whether it should also include additional shares that are acquired as a result of purchase or transfer. As set forth above, such a determination could turn in part on the interpretation of the statutory phrases "in connection with a dividend reinvestment plan…" and "while held as part of such plan…" in Sec. 1012(d)(1). Excluding such shares from the averaging pool increases the tax lot accounting complexity that brokers would face. Any excluded shares would need to be separately tracked so that basis and short-term/long-term gain/loss determinations could be made under the rules generally applicable to stock.

As a related issue, even to the extent subsequently acquired shares are eligible for averaging, it must be considered whether such shares and the related dividend reinvestments can be combined with previously acquired shares and reinvested dividends that already comprise the holding of a dividend reinvestment plan for averaging purposes or whether separate averaging pools must be maintained. Requiring brokers to maintain separate average pools for identical stock held in connection with a dividend reinvestment plan would increase the tax lot accounting complexity that brokers would face.

It should also be noted that the inclusion of broker sponsored plans raises practical issues relating to the transfer of customer accounts. For example, what if a customer transfers her portfolio stock holdings from a broker offering a dividend reinvestment plan for such stock to one that does not offer such a plan? Are subsequent acquisitions of stock identical to stock that was previously averaged excluded from averaging (because the subsequently acquired identical stock was not acquired as part of a dividend reinvestment plan)? Similar concerns could arise if an issuer or its agent discontinues a dividend reinvestment plan.

There are also practical issues relating to when a dividend reinvestment plan begins and when it ends or the treatment of excluded shares. For example, assume that an issuer (or its agent) or a broker begins to offer a dividend reinvestment plan for a particular stock. Presumably, all previously acquired shares currently held by the taxpayer that are the source of dividends reinvested under the plan are included in the averaging pool pursuant to the second clause of Sec. 1012(d)(4)(B). However, by negative inference it could be presumed that any prior or future holdings of such stock that are excluded from the dividend reinvestment plan (i.e., the dividends of such stock are not reinvested in additional shares) are not eligible for averaging and are excluded from the averaging pool.

11. How to maximize the utility of the single-account election for stock acquired in connection with a dividend reinvestment plan or stock held in a regulated investment company, particularly where basis and holding period information for pre-effective date stock is weak or unclear;

RECOMMENDATION:
We recommend that the IRS consider penalty relief in connection with information return reporting that relates to data from pre-effective date shares that are included in an averaging pool as a result of a single account election. We recommend that the IRS should consider a lower, good faith standard of care in connection with such data.

DISCUSSION:
Secs. 1012(c)(2)(B) and 1012(d)(3) permit a fund (or a broker holding stock as nominee) and presumably a broker (or other equivalent person in the context of a dividend reinvestment plan) to make a so-called single account election treating all stock in such fund as covered securities subject to basis reporting. This election was intended to permit the simplification of averaging computations by permitting the fund or broker (or other permitted elector) to maintain only one averaging pool rather than two separate averaging pools—one comprised of pre-effective date shares and another comprised of post-effective date shares.

Some funds or brokers may not make such an election due to concerns regarding the quality of basis and holding period data relating to pre-effective date shares and the potential liability for related information return penalties. As a result, brokers might avoid making the election and thereby incur the additional costs and calculations resulting from maintaining two separate averaging pools. We believe that the overall effectiveness of broker cost basis reporting will be improved by measures that reduce administrative costs for brokers and that reduce the necessity for separate tracking systems for different securities. Accordingly, we recommend a reduction in a broker's responsibility for pre-effective date cost basis information as a means of reducing obstacles to the making of the single account election.

Reconciliation with Customer Reporting

12. How to ensure that broker reporting on Form 1099-B and customer reporting on Schedule D of Form 1040 are maximally consistent, including whether brokers should report separately for securities subject to basis reporting or report the basis of securities that are not covered securities, for example, securities purchased by their customers prior to 2011;

RECOMMENDATION:
We believe that brokers should report sales on a detailed lot-by-lot basis (taking into account the wash sale sublot requirement previously discussed) to both customers and the IRS as opposed to merely a transactional basis as is the case now. We also believe that the lot-by-lot requirement addresses and provides the general maximal consistency between customers and brokers, which is necessary. We believe that in general no change in present practices should be made regarding cost basis information reporting by brokers with respect to securities that are not covered securities (except in the case of a single account election under Sec. 1012(c)(2)(B)). As is presently the case, a broker may decide to provide cost basis information for those securities to customers but, if so, will take appropriate steps to limit its responsibility for the information provided to reflect both source inaccuracies or limitations and decisions it may have made regarding a specific lot selection assumption. Given the potential for high error rates, we doubt whether the benefits of having this information reported to the IRS warrant the additional effort that would be needed to craft special rules respecting responsibility for the information reported. We further believe that transactions involving the sale of both covered and noncovered securities (based on the applicable lot relief method) should be bifurcated and the gross proceeds portions relating to each should be separately stated and reported on separate forms. Otherwise, it will difficult for taxpayers and the IRS to reconcile the partially reported cost basis information.

DISCUSSION:
A major challenge presented by the cost basis reporting legislation is the probability of a high error rate in reported cost basis information, which exists for multiple reasons:

- the transition period needed to capture information;
- single account reporting (lowest common denominator reporting requirement recognizes practical problems of reporting entities) versus multiple account wash sale compliance (high compliance objective);
- other basis adjustments (gifts, deaths) and character rules (RICs, REITs);
- and inaccuracies in data available to brokers (errors on inter-broker transfers, corporate action ambiguities).

As a result, a procedure for reconciling the information on Forms 1099-B and customer reporting on Schedules D is essential.

Separate issues are presented respecting (1) information to be reported to the IRS, (2) information to be reported to taxpayers, and (3) information retention requirements.

With respect to information to be reported to the IRS, an initial question is whether gross proceeds and cost basis information should be reported on an aggregate basis for a stock sale by CUSIP number (or other separate security identifier) or separately for each lot of stock that has a separate cost basis or holding period. For example, a customer may sell 1000 shares of stock, which was acquired in two separate purchases. Assume that the gain or loss on the sale of one lot is short-term due to the holding period of such lots while such gain or loss on the other lot is long-term. Should the broker report gains and losses for the aggregate 1000 shares, or for the two separate lots. We believe the latter.

Currently, the regulations implement gross proceeds reporting for sales of stocks and securities on a transactional basis (i.e, with respect to each sale). A separate Form 1099 is required for each sale of stock or securities. Treas. Reg. 1.6045-1(c)(2). The details that must be reported are required to be stated on a transactional basis as set forth in Treas. Reg. 1.6045-1(d)(2). The instructions to Form 1099-B refer to this as "transactional reporting" and indicate that a separate form is to be filed for each transaction. The broker is directed to enter the CUSIP number for the security in Box 1a and the " aggregate gross proceeds from all disposition of securities" in Box 2.

Reporting in the aggregate may not provide the detail necessary to satisfy the requirement to report long-term and short-term gain or loss as required under the cost basis reporting law by Sec. 6045(g)(2)(A). For example, a single sale of 200 shares of ABC stock could involve the sale of more than one tax lot of ABC stock and the gain or loss on one lot could be long-term while the gain or loss on the other could be short-term. The customer's tax lots would likely vary in amount and holding period. The determination of gain or loss would depend on the lots deemed sold under the customer's lot relief method (FIFO or HIFO for example). Also, one lot could trigger losses that could be subject to deferral under the wash sale rule while the other lot may not.

One approach to address the necessary level of detail would require that the broker provide information to both the IRS and taxpayers that breaks down each transaction into sub-transactions for each lot. A shift to lot-by-lot reporting may, however, significantly increase the data storage and processing requirements of the IRS to an extent that may exceed or challenge its existing computer capacity.

An alternative approach would be to retain the present approach of permitting aggregate reporting by transaction to the IRS but require that the broker provide lot-by-lot information to taxpayers. Schedule D to Form 1040 could provide a box for a taxpayer to identify that the results reported reflect a disagreement with the cost basis information reported by the broker. The taxpayer would then be required to attach to the return the lot-by-lot information received from the broker, together with an explanation of the disagreement and the basis for the disagreement. Brokers would in turn be required to retain the returns provided to taxpayer with the underlying supporting information for a prescribed period.

In the context of taxable transaction reporting, we believe that reporting by lot to the taxpayer and by transaction to the IRS would seriously compromise the effectiveness of

the information reporting regime for the IRS. It would introduce administrative issues in verifying the accuracy of the information provided to taxpayers and would reduce the ability of the IRS to mine the information for audit selection and other purposes.

For transactions reported for calendar 2011 (as well as for other subsequent years depending on lot relief method and security type), cost basis reporting may apply to only a portion of the tax lots that are deemed sold under the taxpayer's applicable lot relief method in connection with a single sale transaction. Presumably, gross proceeds for the entire sale is subject to information reporting under Sec. 6045 even though only some of the tax lots (those relating to covered securities) would be subject to basis reporting. A system that reports such transactions in the aggregate would appear unbalanced given that all of the proceeds are reported while only a portion of the basis would be. As a result, reporting transactions in this manner would be difficult for taxpayers and the IRS to understand and reconcile. Simplistically, such transactions would appear to overstate the potential gain (or understate loss) due to the missing basis information for the noncovered security portion.

13. How to ensure consistency between customers making specific identification of securities sold or transferred and broker reporting;

RECOMMENDATION:
We believe that consistency would be best achieved by requiring brokers to report cost basis using lot relief methods that the customer actually uses in computing gains and losses on his tax return. Brokers should be expected to support all lot relief methods available to taxpayers on a transaction by transaction basis. In this manner, customers can select a lot relief method and the broker can accommodate their selection. This should minimize related consistency issues in computing gain and loss.

DISCUSSION:
See the response to Notice Issue No. 4 (which describes procedures for the investor to communicate to its broker the lot selection method used by the investor for a particular sale).

Assuming adequate procedures for exchange of information between investor and broker, a question would remain whether a broker will be permitted to determine that it will support only certain lot selection methods (e.g. FIFO or highest in/first out (HIFO)) but not others. Sec. 6045(g)(2)(B)(i)(I) could be read to require a broker to support a wide variety of methods but could be read more narrowly. In principle, if a broker is permitted to support less than all of the available lot selection methods, it would inform investors of the methods it supports and advise a potential account holder to go elsewhere if it wishes to use an unsupported method. But then the possibility could still exist under current regulations that on a particular sale the investor on its return could use a lot selection method other than that applied by the broker in reporting cost basis information. That is, the existing tax rules would not prevent an investor from using an unsupported lot selection method.

In short, we believe that the only way to ensure consistency between customers making specific identification of securities sold and broker reporting is either to require brokers to support all potential lot selection methods, or require investors to use only those lot selection methods their brokers support. We believe that the cost basis reporting law requires brokers to respect customer choices on lot relief method selection at least with regard to securities other than mutual fund and DRIP shares eligible for averaging (for mutual fund and DRIP shares, the lot relief method should be selected at the opening of the account—See response to Notice Issue. No. 6).

14. How to ensure that reconciliation is possible if broker reporting should differ from customer reporting;

RECOMMENDATION:
Schedule D should be modified to include a section reconciling cost basis reported by brokers with the amount reported by the taxpayer, showing the amount of any difference for each recognized gain or loss reported. The taxpayer should explain the reason for the difference in an attached statement to the return and should retain records supporting the difference or the alternate taxpayer's calculation of basis.

DISCUSSION:
See the response to Notice Issue No. 12, which envisages that at a minimum brokers will apply lot by lot detail in the information return to the taxpayer. Schedule D to Form 1040 then would include a box to indicate that the taxpayer disagrees with the broker's report of the cost basis associated with tax lots comprising a particular transaction. It might be argued that a tax lot based reporting approach might be too detailed but we note the continued conversion to electronic filing and the routine importing of data in tax return preparation software that we believe mitigates this concern. To assist in selection of returns for review, another box might show the amount of the difference in resulting gain or loss. The taxpayer would then attach a statement explaining the reason for the difference in cost basis claimed together with the lot by lot information received from the broker. The taxpayer would be required to retain records detailing the difference or otherwise supporting her calculation of basis for tax return filing purposes. Disparities could result from differences in lot selection methods, wash sale basis adjustments not captured, or other adjustments not captured. For example, cost basis as calculated for basis reporting purposes by brokers may not be identical to cost basis as determined by taxpayers due to wash sales that arise between different accounts or as a result of the acquisition of substantially identical securities. See Sec. 6045(g)(2)(B)(ii).

15. Whether customers, after a sale, may identify or change the identification of specific stock sold and, if so, for what period of time or by what deadline;

RECOMMENDATION:
A customer should be permitted to identify or change the identification of specific shares after the sale date but by the settlement date consistent with Rev. Rul. 67-436. A broker should be permitted to identify specific shares after the settlement date within a reasonable period of time on confirmations provided to the customer (such as one week). The IRS should explicitly permit such customer identifications and broker confirmations to be delivered electronically. The IRS should provide an explicit exception for extenuating circumstances under which the identification of specific shares by the customer or the confirmation by the broker could be changed or provided outside of the time limits normally applicable.

DISCUSSION:
Treas. Reg. 1.1012-1(c) sets forth the principal guidance on specific identification of shares sold. Additional relevant guidance can be found in Rev. Rul. 61-97, 1961-1 CB 394, clarified by Announcement 61-77, 1961-36 IRB 34; Rev. Rul. 67-436, 1967-2 CB 266; and Priv. Ltr. Rul. 9728021, dated April 10, 1997.

Treas. Reg. 1.1012(c) provides slightly different rules depending on whether stock is held in physical form or is held in the custody of a broker or agent. The rules appear slightly different.

Treas. Reg. 1.1012-1(c)(2) addresses stock held in physical form and provides that specific identification is accomplished by the delivery of the certificate(s) representing the specific shares by the taxpayer to the transferee. Note that such a delivery would generally occur after the sale in compliance with applicable settlement procedures. Treas. Reg. 1.1012-1(c)(3) addresses stock held in the custody of a broker or agent. It includes two separate rules—one for circumstances where the identified stock is represented by discrete separate certificates (Treas. Reg. 1.1012-1(c)(3)(i)) and another for circumstances where the identified stock is represented as a portion of a single certificate involving multiple tax lots (Treas. Reg. 1.1012-1(c)(3)(ii)). Treas. Reg. 1.1012-1(c)(3)(i)(A) requires customer identification at the time of the sale or transfer. Treas. Reg. 1.1012-1(c)(3)(ii)(A) requires customer identification at the time of delivery of the certificate to the broker or agent. Under both rules for stock held in custody, the broker or agent must confirm such identification to the customer/taxpayer (Treas. Reg. 1.1012-1(c)(3)(i)(B) and (c)(3)(ii)(B)).

Rev. Rul. 67-436 provides clarification of the timing of customer identification and the timing of the broker confirmation under Treas. Reg. 1.1012-1(c)(3)(i). The ruling involves an investment holding company with stock held in custody by a broker that is commingled with investments of other customers. Under the ruling, the broker sells stocks on behalf of the company pursuant to certain authorizations. Once a trade occurs, the broker then notifies the holding company of the sales. The holding company then notifies the broker in writing of the specific identification of shares prior to the settlement

date (4 days after the trade date). Within 5 days after the settlement date, the broker confirms in writing to the company the identity of the shares sold. The ruling notes that the customer does not provide identification of shares by the sale or trade date. However, the ruling holds that the notification by the customer to the broker within the 4-day period before the stock is delivered satisfies the requirement of Treas. Reg. 1.1012-1(c)(3)(i).

Priv. Ltr. Rul. 9728021, dated April 10, 1997, involved a standing order procedure whereby a broker's customers could establish a standing order with the broker to sell identified stock with certain specified characteristics such as highest-cost first. Confirmation slips are provided to customers, indicating that such shares were in fact sold and specifying specific tax lots in certain cases.

Both Rev. Rul. 67-436 and Treas. Reg. 1.1012-1(c)(3)(ii)(A) appear to support the identification of specific shares by the settlement date, rather than the earlier sale or trade date. Thus, customers should be able to identify specific shares by the settlement date, rather than earlier sale date, based on this existing authority. Given this rule, customers should also be able to change the identification of specific shares provided it is done by the settlement date.

There are several other important questions for which guidance could be helpful. First, we believe the IRS should specify what period of time constitutes a reasonable period of time during which brokers must provide written confirmation of specific shares sold. Second, we recommend that the IRS issue clarification or guidance that written instructions and confirmations can be provided by customers and brokers electronically. We believe this would be helpful and could eliminate needless paperwork. Third, we recommend that there be an explicit exception for extenuating circumstances under which the identification of specific shares by the customer or the confirmation by the broker could be changed or provided outside of the time limits normally applicable.

Special Rules and Mechanical Issues

16. The scope of the wash sales exception, including the definition of "identical securities" (including identical options), the wash-sale period, and any de minimis or other exceptions;

RECOMMENDATION:
The term "identical securities" should refer only to securities with the same CUSIP number. If a security does not have a CUSIP number (e.g., a foreign security), a comparable identification number (e.g., SEDOL) should be used. There should not be any de minimis exceptions for wash sales.

DISCUSSION:
Congress specified that a broker should report basis under Sec. 6045 only with adjustments for wash sales with "identical securities" not with "substantially identical" securities as provided in Sec. 1091. Sec. 6045(g)(2)(B)(ii). We believe that Congress

decided to relieve brokers from the burden of determining the scope of "substantially identical." However, suggestions were made to the congressional staff over a number of years regarding whether a de minimis exception from wash sale reporting was also necessary. We note that in spite of such suggestions, Congress did not include any rule to relieve brokers from de minimis adjustments for wash sales in computing the basis of securities for cost basis reporting purposes. It is our understanding that both large and small adjustments from wash sales are already regularly processed by some brokers and systems. Given such technological advances and existing practices, along with prior congressional staff discussion regarding whether an exception was necessary, the lack of a de minimis exception for wash sale basis adjustments in the statute for broker reporting seems clear.

Year-end wash sale adjustments might also be considered a concern due to the thirty day window triggering a wash sale on an earlier sale at a loss based on a subsequent purchase, but Congress extended the deadline to furnish information returns to customers to Feb. 15th. Thus, for example, a wash sale occurring on December 31st that arises as a result of the acquisition of identical shares on the following January 30th can be reportable on Feb. 15th. We believe that the congressional staff considered this issue as well in connection with extending the Form 1099 delivery deadline to Feb. 15th.

A narrow issue under the identical securities rule relates to issuer or security name or CUSIP changes and the impact of corporate actions such as name or share class or mergers on wash sale processing. For example, ABC company undergoes a name change and is renamed ABCD company on June 15th, 2009. Its shares are reissued with a new CUSIP. Customer sells ABC common stock on June 14th, 2009 at a loss. Customer purchases an identical quantity of ABCD common stock on June 16th. The IRS should consider whether the broker must process this transaction as wash sale for customer given that the ABCD stock has a CUSIP that is not identical to the ABC stock CUSIP.

17. How to apply the rules for basis reporting of options;

RECOMMENDATION:
We generally believe brokers should apply present law in addressing the substantive law issues necessary to report basis for options. A broker generally should carry premiums in a deferred account for their customers, and report gains and losses when the option transaction closes (or make proper adjustments to the purchase or sale of the underlying security).

DISCUSSION:
The new legislation requires brokers to report gains and losses for option transactions by Jan. 1. 2013. In general, a taxpayer must treat a premium for an option as a nondeductible capital expenditure or as a receipt that is carried in a deferred account until the option transaction is closed. See generally Rev. Rul. 78-182, 1978-1 CB 265, Rev. Rul. 71-521, 1971-2 CB 313. If an option is exercised, the amount received with respect to the grant of the option or paid with respect to the acquisition of the option is treated as

an adjustment to gross proceeds or as an adjustment to basis, as the case may be. Id. The new legislation requires brokers to report accordingly. See. Sec. 6045(h).

18. Whether rules, including transition rules, are required to address the change in timing for reporting of short sales from the date the short sale is entered into to the date the short sale closes;

RECOMMENDATION:
The IRS should provide guidance to taxpayers and brokers alerting them to the potential duplicative reporting for short sales opened in 2010 that are closed with covered securities during 2011. We recommend the IRS require the reporting of all short sales involving stock or other types of covered securities based on when such sales are closed rather than when they are opened for the first applicable effective date year as a transitional rule to avoid differing types of reporting of short sales involving the same type of underlying security (such as stock). Thus, effective for short sales occurring on or after January 1, 2011, we recommend that there should no longer be reporting of gross proceeds on the opening of short sales. We also recommend that the IRS clarify that brokers are not required to report constructive sales potentially arising with respect to the opening of short sales (or otherwise take into account the constructive sale rule for cost basis reporting purposes).

DISCUSSION:
A short sale generally involves the borrowing of stock from a broker and the immediate sale of the borrowed stock on behalf of the customer today (the short sale open date). The customer repays the loan by delivering an equivalent amount of identical shares at an agreed future date (the short sale close date). Under federal income tax law, a short sale generally results in the recognition of taxable gain or loss at the time the short sale is closed (except as a result of the constructive sale rule, if applicable) rather than at the time it is opened. Gain or loss is generally determined by comparing the gross proceeds received from the short sale with the cost basis of the shares delivered by the customer on the close date. Note that the receipt of gross proceeds on the open date does not generally trigger a taxable event.

Gross proceeds from short sales are currently reported at the time the short sale is entered into pursuant to the definition of a sale under Treas. Reg. 1.6045-1(a)(9). Pursuant to new Sec. 6045(g)(5), short sales under the new cost basis reporting law will generally be reported in the year they are closed. The effective date of this new rule depends on whether the securities subject to the sale are covered securities.

Because short sales (assuming the constructive sales rules of Sec. 1259 are not triggered) are generally not taxed until the year of the sale, taxpayers currently back-out Form 1099-B reported short sales that close in a subsequent tax year in computing taxable gains and losses for purposes of Schedule D.

Changing the timing of reporting short sales will mean that some short sales will be reported twice—once in the year that the short sale is entered and again in the year the short sale is closed if the short sale is closed with a covered security. Such duplicative reporting could be confusing to taxpayers.

In addition, because the effective date for the new reporting rule for short sales at the time of close is dependent on whether the short sale is closed with a covered security, it could be possible for calendar years beginning with 2011 that some short sales could be subject to reporting based on when they are opened (if the short sale is closed with a security that is not a covered security such as a security acquired before the applicable effective date) while others closed with covered securities would be subject to reporting based on when they are closed.

Under the constructive sale rule of Sec. 1259, the opening of a short sale of a security (or other financial position) can trigger the recognition of gain by a taxpayer at the time the short sale is opened if at such time the taxpayer holds an appreciated financial position to which the short sale relates. If the constructive sale rule is triggered, it would appear appropriate to report a triggering short sale at the time it was opened rather than at the time it is closed.[2] Unlike wash sales, most cost basis reporting systems do not currently take into account constructive sales and the systems development for such reporting could be complex.[3] In addition, the IRS has not issued regulations relating to constructive sales and thus mechanical aspects of the rule relating to corresponding subsequent adjustments as a result of recognizing gain on a constructive sale are uncertain. For these reasons, we recommend that the IRS clarify that brokers should not be required to make basis adjustments for any cost basis reporting purpose including with respect to short sales or options as a result of a potential constructive sale.

[2] Technically the effect of Sec. 1259 might be considered to be a sale of the appreciated security for which the gross proceeds are the proceeds from the short sale. The current definition of a "sale" in Treas. Reg. 1.6045(a)(9) does not appear to have such a "sale" in mind. If a constructive sale was treated as a sale of the appreciated position for purposes of Sec. 6045 generally, the application of Sec. 6045(g) would depend on whether the appreciated position is a covered security.

[3] Due to the closed transaction exception in Sec. 1259(c)(3), a broker cannot definitively determine whether a constructive sale has been triggered until after the close of the taxable year; and even then the availability of the closed transaction exception may depend on the existence or not of risk reduction positions in other accounts, see Sec. 1259(c)(3)(A)(iii).

19. How to address mechanical issues relating to the computation of basis, such as adjustments for debt securities (for example, as a result of original issue discount, market discount, acquisition premium, or bond premium), gift-related adjustments, death-related adjustments, section 1043 basis rollovers, regulated investment company and real estate investment trust distributions representing return of capital, regulated investment company load adjustments, and the mark-to-market method of accounting for securities;

RECOMMENDATION:
We begin by noting that this issue has a "grab bag" flavor to it. Some of the referenced adjustments are complex, highly factual and/or lack clear regulatory guidance on their application. We believe that it could take substantial additional time to fully consider this issue. However, we agree with the need to begin considering these adjustments immediately due to their complexities and in assessing them we believe that these mechanical adjustments could be sorted into different categories: fundamental basis adjustments; anti-abuse basis adjustments; alternative tax accounting methods and other.

We believe that the listed adjustments for debt securities, gift and death-related transfers are fundamental basis adjustments.

We recommend that basis adjustments for debt securities (original issue discount, market discount, acquisition premium and bond premium) should be required because they are fundamental to the computation of gain or loss on the disposition of debt securities. We are also unaware of any legislative intent that such adjustments be excluded in computing the basis of debt instruments for cost basis reporting purposes and we believe that the delayed effective date for cost basis reporting for debt securities was related to the expectation that preparing systems to account for such adjustments would require additional time to prepare (hence the January 1, 2013 effective date for such securities). Although we understand the potential processing system difficulties, we are concerned that the reporting of such adjustments without taking into account the specific purchase prices or various elections of the holders of debt securities would not address the policy goals of consistency and simplicity behind the basis reporting legislation.

We recommend that gift and death-related basis adjustments should not be required to be made by brokers for cost basis reporting purposes. We believe that this was the legislative intent and is consistent with the use of the word "acquired" in Sec. 6045(g)(3)(A)(i). However, we note that many brokers and financial advisors currently provide gift and death-related basis adjustments to some of their customers as a customer service. We believe that the inclusion of such adjustments promotes consistency between broker reporting and taxpayer reporting. Accordingly, we further recommend that brokers and other applicable persons within the meaning of Sec. 6045A should be permitted to make gift and death-related basis adjustments (although such adjustments would not be required). We believe that such reporting could eliminate potential audit inquiries that could otherwise arise if the taxpayers report a higher basis due to step-up on death, for example, in connection with the sale of inherited stock.

We consider Sec. 1043 adjustments to fall within the "other" category. We recommend that a similar optional inclusion of such adjustments could be permitted to be made for basis reporting purposes by brokers and other applicable persons in a manner similar to that regarding gift and death-related basis adjustments. We do not believe such adjustments should be required. We also recommend a revision of Form 8824 to set forth the reduced basis of reinvestment securities on a lot by lot basis and that the taxpayer be required to give a copy of Form 8824 to persons holding those securities. If those persons are brokers or are otherwise applicable persons under Sec. 6045A, those persons could then be expected to reflect the information on Form 8824 in providing cost basis information.

The RIC and REIT related basis adjustments referenced above fall within the anti-abuse category. The concern would be that without requiring brokers to make such adjustments, it could be difficult to enforce their application by taxpayers. We recommend that return of capital information should be treated as a corporate action subject to Sec. 6045B reporting in order to provide such information as timely as possible to brokers, that such information should reconcile with amounts reported in Forms 1099-DIV, and that persons responsible for cost basis reporting, including applicable persons in the case of transfers, should be required to use reasonable efforts to reflect return of capital adjustments in the cost basis of stock. In addition the amount of return of capital adjustments should be separately stated. We recommend that brokers be required to properly account for capital loss recharacterizations as long-term for RICs and REITs pursuant to Secs. 852(b)(4) and 857(b)(8). We also recommend that brokers be required to properly account for load charges in accordance with Sec. 852(f) with respect to sales and purchases of front-end load RIC shares.

Mark-to-market accounting is a different tax accounting method that does not generally rely on cost basis (although intra-year dispositions and acquisitions must be reconciled against open or close of year market values). We generally recommend excluding mark-to-market securities and taxpayers from broker cost basis reporting.

DISCUSSION:
The discussion set forth below is intended to provide an overview of our understanding of the relevant rules respecting the basis adjustments referenced in this issue.

I. Debt instruments

The cost basis of debt instruments must be adjusted by income inclusions and deduction and by cash receipts. The following discussion focuses primarily on the effect of various rules affecting accounting for income inclusions and deductions.

1. Straight debt securities (excluding securities to which Sec. 1272(a)(6) applies). (a) Election to treat all interest as OID. Treas. Reg. 1.1272-3(a) provides that an investor may elect to include all interest that accrues on an instrument under a constant yield method. For this election, interest includes "stated interest, OID, de minimis OID, market discount, de minimis market discount, and unstated interest, as adjusted by any

amortizable bond premium or acquisition premium." The election is made by attaching a statement to a timely filed tax return for year in which the debt instrument is acquired. While the regulations state that the election may be made separately for individual bonds, Treas. Reg. 1.1272-3(b)(1), that general rule is largely overridden by special rules for bonds acquired with bond premium or market discount. Those special rules deem the holder to have made a corresponding election under Sec. 171(c) or 1278(b), as applicable, for all bonds held by the taxpayer. The election is not available for tax-exempt bonds. As discussed below, the availability of this election (the "all interest election") complicates choices for dealing with OID, acquisition premium, bond premium, and market discount.

(b) Original issue discount and acquisition premium. With certain exceptions, Sec. 1272(a)(1) requires a holder of an OID debt instrument to include OID on a constant yield basis. Sec. 1272 also creates the concept of adjusted issue price, which is essentially the original issue price increased by OID accruals. If an investor acquires an OID instrument at a price in excess of its adjusted issue price but less than its stated redemption price at maturity (acquisition premium), the investor reduces its OID income by a portion of the acquisition premium. Sec.1272(a)(7). That offset amount is calculated under a simplified pro-rata allocation formula, with the effect that the amount of OID included varies somewhat from the amount that would be included if the investor determined a yield to maturity based on its acquisition price and then calculated its includible OID income under a constant yield method (an approach that would effectively offset acquisition premium under a constant yield method). This statutory pro-rata method results in aggregate annual accruals that typically differ from those based on constant yield that are generally used for financial and investment yield purposes.

Brokers are required to report original issue discount on Forms 1099-OID. The amount reported does not take into account any offset for acquisition premium or the possible effect of an election under Sec. 1273(a). Instead, the instructions put the burden on the taxpayer to make the required adjustments.

As noted above, a holder may elect to include all interest under a constant yield method. As an example, if a debt instrument is issued with both stated interest and OID and is acquired with acquisition premium, then stated interest, OID, and acquisition premium would all be taken into account under a constant yield method.

In sum, brokers currently report only OID income based on the original issue price of the debt instrument. The amount reported is accurate only for original holders but not for subsequent purchasers who pay a price other than adjusted issue price. Cost basis adjustments for OID will similarly be accurate only for original holders.

From a purely mechanical point of view, it would appear possible for brokers to apply the rules for amortizing acquisition premium as an offset to OID income. This could be required for both OID income reporting purposes and for cost basis reporting purposes. An issue would be presented, however, by the availability of the all interest election. Brokers would need to know on a customer by customer basis whether such an election

had been made by the investor. For secondary market purchasers, income and basis adjustments calculated in conformity with that election would differ from the income and cost basis calculations otherwise applicable. Moreover, for bonds acquired with acquisition premium but without bond premium or market discount, the election could be made on a bond by bond basis.

As part of implementing cost basis reporting for debt instruments, consideration should be given to modifying the rules respecting the reporting of income from such instruments. For example, a modified rule might require that reported OID income take into account amortization for acquisition premium. In addition, consideration should be given to modifying the all interest election. One possible modification would be to extend the rule for market discount and premium bonds so that the election would apply to all bonds in all cases. In addition, the period for making the election could be shortened to, say, one month and a requirement that the broker be notified of the election could be added. As an alternative, consideration could be given to modifying the statutory acquisition premium amortization rule to provide a constant yield amortization method for debt instruments held through a person subject to Sec. 6045(g) broker cost basis reporting.

It should be noted that Secs. 1281-1283 provides a separate set of OID related rules for debt instruments with a maturity date not more than 1 year from the date of issue ("short-term obligations"). In addition, Sec. 1286 provides a special OID rule for stripped bonds. Investors can acquire short-term obligations or stripped bonds and they would appear to qualify as a "note, bond, debenture, or other evidence of indebtedness" that would constitute specified securities within the meaning of Sec. 6045(g)(3)(B)(ii) for broker cost basis reporting purposes. No regulations have been issued by the IRS regarding the definitions or computational aspects of the OID rules relating to such instruments other than very limited guidance under Treas. Reg. 1.1286-1 and Treas. Reg. 1.1286-2.

(c) Premium. The situation for premium is somewhat simpler. A constant yield method is used to determine the amount of amortizable basis. Amortization is required for tax-exempt bonds and reduces cost basis. Sec. 1016(a)(5). Amortization is elective for taxable bonds but is a global election for all bonds pursuant to Sec. 171(c). The amortization amount reduces interest income and cost basis. Secs. 171(a)(1), 171(e) and 1016(a)(5).

Under present practices, a broker is required to report interest income but not premium amortization. Many brokers do, however, report premium amortization to customers as a service.

Consideration should be given to modifying the rules regarding the reporting of interest to require the reporting of premium amortization, either through netting of the interest amount reported or as a separate amount. Brokers should be permitted to assume that a customer has made the Sec. 171(c) election unless notified to the contrary. And consideration should be given to a statutory amendment requiring premium amortization for bonds held through persons subject to Sec. 6045(g) cost basis reporting.

(d). Market discount. The situation for market discount is more complicated, but our recommended approach is simpler. Taxpayers are not required to include market discount in income until a disposition of the bond, Sec. 1276(a), but may elect current inclusion of income which results in a corresponding current basis adjustment to the bond, Sec.1278(b). Accrued market discount may be calculated on either a ratable accrual or a constant yield basis. Sec. 1276(b). However, unlike the OID rules, the IRS has never issued regulations relating to market discount comprehensively addressing various computational and definitional matters. We believe that few individual taxpayers elect to include market discount accruals as a current inclusion in income.

Accordingly, we recommend that brokers not be required to adjust basis for accrual of market discount unless the taxpayer has advised the broker that the Sec. 1278(b) election has been made. Consideration should be given to whether to retain the ratable inclusion method for bonds held through a person subject to Sec. 6045(g) cost basis reporting and whether to require income information returns for accrued market discount when the Sec. 1278(b) election has been made.

(e). Sec. 1272(a)(6) bonds; REMIC regular interests. There are special OID rules for debt instruments subject to likely prepayment such as REMIC regular interests and mortgage-backed debt. See Sec. 1272(a)(6). In general, OID is accrued based on anticipated prepayments determined at the time the debt instrument is issued with a method for subsequently adjusting for actual prepayments. The major problem posed by REMIC regular interests and other debt instruments subject to these rules is accounting for the effects of actual prepayments that differ from projected prepayments. With respect to instruments not subject to prepayment, the future cash flows are known (or can be stated pursuant to a generally accepted convention in the case of variable interest instruments). Accordingly, it is possible to establish a computer system that will calculate income and deduction adjustments to basis using only the original issue price and the customer's purchase price, But that is not possible for instruments subject to prepayments, because the prepayments will alter the future cash flows by accelerating principal and eliminating interest. There are no OID regulations specifically addressing the computational issues relating to OID accruals under the special Sec. 1272(a)(6) prepayment method.

Current practice for REMIC regular interests based on legislative history in the absence of implementing regulations is to project and re-project future prepayments using the prepayment assumption used in the original pricing of the interests. Because the effect of mortgage prepayment on future mortgage pool cash flows varies with the origination date and interest rate of the mortgages that are prepaid, holders cannot independently determine the effects of mortgage prepayments. Rather, they rely on OID accrual information and market discount and premium accrual "factor sheets" provided by mortgage servicers. However, market practice is not uniform with respect to the use of these factor sheets. For example, many mutual fund complexes must accrue income throughout their tax year and find that the factor sheets are not available on a timely basis. Also, it can be difficult to access the data in the factor sheets without subscribing to a fee required data service.

A further complicating factor arises from the potential for partial worthlessness deductions. Because REMICs are not corporations, Sec. 860A(a), REMIC regular interests are not securities to which the rules for worthless securities under Sec. 165(g) apply. Frequently, REMIC regular interests are issued in tranches or separate series with differing maturities and relative subordination. In today's market conditions, holders may be able to determine that collection of principal is doubtful for the later, most subordinated maturities of REMIC regular interests issued by a particular REMIC and may, therefore, claim a partial worthlessness deduction.

In light of the foregoing matters and complexities, we recommend that cost basis reporting not be required for REMIC regular interests until the issuance of more definitive guidance.

II. Gift & Death Related Adjustments

See the discussion in our response to Notice Issue No. 2.

III. Sec. 1043 Basis Rollovers

Sec. 1043 provides relief from recognition of gain for certain federal officials who divest property in order to comply with a Federal conflict of interest requirement, including a request by a Congressional committee as a condition of confirmation. At the election of the taxpayer, gain is recognized only to the extent that the amount realized on the sale exceeds the cost of a permitted rollover reinvestment within the 60-day period beginning on the date of sale. Gain not recognized is applied to reduce (in the order acquired) the basis of the rollover reinvestment property. Sec. 1043 can apply to property held in trust, see Sec. 1043(b)(5), and we understand that persons who are appointed to senior positions in the Executive Branch of the Federal government frequently have securities held in trust during their period of service in public office. Transactions to which Sec. 1043 applies are reported on Form 8824. This form identifies the aggregate basis of the reinvestment property but does not identify specific items of reinvestment property or break out the cost basis for specific properties.

Under current procedures, the person with the most complete access to information regarding the cost basis reduction adjustments resulting from a section 1043 election is the taxpayer making the Sec. 1043 election. The broker effecting the reinvestment transaction will not necessarily have information regarding the basis adjustment. An electing taxpayer is already required to file Form 8824. Amending the form to include the basis adjustment information for specific reinvestments and requiring that the form be given to persons holding the security would not significantly increase the burden for electing taxpayers and would make the cost basis reporting regime more comprehensive.

We note that basis adjustments can arise under other rollover provisions, such as Secs. 1044 and 1045. We have not undertaken an analysis to determine whether similar action would be appropriate for those provisions.

IV RIC and REIT Adjustments

1. Return of capital distributions. One common adjustment to the basis of shares in a RIC or REIT occurs when a RIC or REIT makes dividend distributions in amounts that exceed its earnings and profits.[4] The excess amount will normally be a return of capital and reduce the shareholder's cost basis. Returns of capital are report on line 3 of Form 1099-Div as "nondividend distributions": and the corporation is required to file Form 5452 as an attachment to its income tax return.

Returns of capital can occur for corporations other than RICs and REITs, and may be frequent for certain public utility companies. But they are a particular issue for RICs and REITs, because those entities generally attempt to distribute all of their income currently so as to avoid a corporate level tax.

Questions may exist regarding the accuracy of the return of capital information in Forms 1099.[5] Moreover, the information is not timely for broker cost basis purposes. It is provided in late January or February of the year following the year to which the return of capital relates.

Returns of capital adjustments create difficult processing problems for brokers because their amounts and their allocation among particular dividends within a year are almost always determined subsequent to the calendar year in which the dividends are paid and received.[6] The shares on which dividends were paid may have been sold, and other shares may have been purchased. In simple cases, as when a taxpayer has held shares during the entire year and still holds the shares when the return of capital information is received, it may be reasonable to require a broker to adjust the cost basis of shares for returns of capital. In other cases, the benefit of requiring basis adjustment may be outweighed by the additional administrative burden. On balance, we recommend that return of capital information should be treated as a corporate action subject to Sec. 6045B reporting in order to provide such information as timely as possible to brokers, that such information should reconcile with amounts reported in Forms 1099-DIV, and that persons responsible for cost basis reporting, including applicable persons in the case of transfers, should be required to use reasonable efforts to reflect return of capital adjustments in the cost basis of stock. But because our recommendation assumes that in a significant number of cases return of capital adjustments will not be taken into account (or will need

[4] A RIC that invests in tax-exempt bonds will generally have no taxable income but is permitted to pay exempt interest dividends under Sec. 852(b)(5) and may do so in amounts that exceed its earnings and profits. This can happen, for example, if the RIC has amortized premium over the period until a bond's maturity and should have amortized premium over the period until an earlier call date.

[5] For many RICs administrative problems exist with respect to the receipt of dividends that may include a return of capital, because the corporation paying the dividend (e.g. a REIT in which the RIC has invested) may not identify the portion of its dividends constituting a return of capital until after the end of the RIC's taxable year. We understand that in practice many RICs handle this separate problem by reasonably estimating the amounts received as returns of capital and then making offsetting adjustments in the following year with respect to amounts distributed or amounts identified as returns of capital, rather than by amending Forms 1099-DIV. See Treas. Reg. 1.451-1(a)(accrual on the basis of a reasonable estimate).

[6] The timing of these differences may also be affected by the taxable year (e.g., a non-calendar year) of the payor corporation.

to be processed retroactively), we also recommend that the amount of return of capital adjustments be separately stated.

2. Short-term loss recharacterization. Secs. 852(b)(4) and 857(b)(8) provide for the recharacterization of short-term realized capital losses as long-term in connection with the disposition of RIC or REIT shares to the extent that with respect to such shares, the holder of the shares has received capital gain dividends (characterized as long-term capital gains for tax purpose without regard to how long the holder has owned such shares) or has been allocated an amount of undistributed long-term capital gains.[7] The recharacterization rule applies if the shareholder disposes of the shares before the shares have been held 6 months.

In general, a broker should have the information necessary to apply Secs. 852(b)(4) and 857(b)(8) in that the long-term capital gain dividends or notices of allocations of undistributed long-term capital gains will be made with respect to the RIC or REIT stock acquired in an account with the broker and held in that account. However, the application of the recharacterization rule depends on the taxpayer's holding period for the stock, which could be affected by transactions occurring in different accounts. Thus, we recommend that the broker be able to determine holding period on a separate account basis and, accordingly, would generally be able to rely on the acquisition date for the shares in applying the six-month holding period requirement.

3. Load charges. Many open-end RICs impose a "front-end load" on new share purchases. Proceeds from the front-end load may be used, for example, to pay compensation to a broker's sales force for selling the fund shares (distribution costs). As a result, those expenses are not paid by the fund itself, which would reduce the investment return of other investors.[8] When an investor buys shares in a front-end load fund, the amount actually invested in the fund is net of the front-end load. An investor that immediately redeemed the purchased shares would incur a loss.

Front-end load funds are often part of a family of funds that facilitate investors' decisions to change an investment from one fund to another fund in the same family by giving investors a "reinvestment right." These funds may waive or reduce the front-end load on the reinvestment in the other fund. Prior to 1989, an investor wishing to invest in Fund B might first invest in Fund A. The investor would quickly redeem the shares in Fund A at a loss and then reinvest in Fund B without a further load charge. In effect, this strategy afforded the investor with an immediate loss for a portion of the intended ultimate investment. This strategy was attacked by the addition of Sec. 852(f) in 1989.

[7] We observe that the Notice Questions generally do not address issues presented by rules affecting holding period (such as the straddle rules under Sec. 1092 or the short sale rules under Sec. 1233), which are relevant to the requirement in Sec. 6045(g)(2) that the information shown on the return indicate whether any gain or loss is short-term or long-term. Sec. 852(b)(4) provides a similar rule denying loss when a shareholder has received an exempt interest dividend but does that rule does not affect characterization of loss as long-term or short-term.

[8] Distribution costs are incurred by virtually all open-end funds and are funded n different ways by different funds or with respect to different classes of shares in multi-class funds, including through annual fees (Rule 12b-1 plan fees) paid by the fund and back-end redemption charges.

Under Sec. 852(f), if a taxpayer disposes of front-end load shares before the 91st day after the purchase date, the front-end load is not included in the cost basis of the those shares to the extent that it does not exceed any reduction in the front-end load for the reinvestment shares. The amount not included in the basis of the initial shares is added to the basis of the reinvestment shares.

In many cases, open-end RIC shares are purchased directly from the open-end RIC and then directly redeemed by the RIC. In these cases, the open-end RIC would have all the information needed to comply with Sec. 852(f). In other cases, investors buy shares through brokers who maintain an omnibus account with the RIC. Because a sale and reinvestment by an individual investor would not necessarily trigger a corresponding sale and reinvestment in the broker's account with the RIC, it is not obvious how a RIC's reinvestment right would be administered in those cases. However, we understand that some RICs have in place procedures by which the investor notifies the broker it is entitled to reduction of the loan fee under a reinvestment right. In these cases, the broker should have the information needed to comply with Sec. 852(f).

V. Mark to Market Taxpayers

1. Sec. 475 taxpayers. Sec. 475 taxpayers include securities dealers and electing commodity dealers, securities traders, and commodity traders. All of these taxpayers engage in a high volume of transactions; and it would be difficult for brokers to determine the effect on cost basis of Sec. 475 mark-to-market treatment given, among other things, the possibility of different taxable years and varying approaches (including more frequent marks than annual). Accordingly, we recommend that cost basis reporting not be required for M-T-M taxpayers. However, these taxpayers could also be required to identify certain securities or commodities as held for investment and not subject to M-T-M. Consideration could be given to whether, in the case of Sec. 475 taxpayers, positions exempt from M-T-M should be held in accounts separate from the M-T-M positions and that cost basis reporting could be required for such positions. Such a rule might include exemptions from cost basis reporting for transactions effected by certain "exempt persons" defined by reference, for example, to form of organization, size or volume of transactions. We are concerned that the burdens of such an approach could outweigh the benefits.

2. Sec. 1256 Contracts. Another major category of M-T-M securities consists of Sec. 1256 contracts. Most of those contracts would not be covered securities except upon exercise of the authority in Sec. 6045(g)(3)(B)(iii)(with respect to derivatives in commodities) or (iv)(other financial instruments).

3. Other M-T-M accounting methods. Some persons may be applying an M-T-M method for notional principal contracts or similar financial instruments in accordance with the preamble to the contingent nonperiodic payment notional principal contract regulations.[9] A broker will not necessarily know whether a customer is doing that or, if

[9] See 2004 CB-1 655, at 660.

so, for what instruments the customer is applying the M-T-M method. On balance, we believe that brokers should provide unadjusted cost basis information for these customers and that provision should be made on the reconciliation form for the customers to document their M-T-M adjustments.

20. What, if any, translation conventions or computation adjustments should be allowed when securities are purchased with foreign currency in an account subject to United States taxation at the time of purchase or in an account that later becomes subject to United States taxation, for example, when an owner of securities becomes a United States citizen;

RECOMMENDATION:
When securities are transferred to an account with a U.S. broker from an account with a non-U.S. broker, the U.S. broker should request cost basis information from the account holder. If the account holder fails to provide the requested information, the broker would then identify the reason for the omission of cost basis information in the return with respect to a later sale of the securities.

DISCUSSION:
1. Clarification of question. At the outset, we note that we believe the material factors for cost basis reporting are not whether securities are purchased with foreign currency but whether the securities are denominated in a foreign currency and whether the purchase is in a foreign account (an account maintained by a person not subject to Sec. 6045) or a domestic account (an account with a person subject to Sec. 6045).[10]

If securities denominated in dollars are purchased with foreign currency, a Sec. 988 transaction may occur with respect to the currency at the time of the purchase. Sec. 988(c)(1)(C); Treas. Reg. 1.988-2(a). The cost basis of the dollar denominated securities would be their dollar purchase price. But the purchase of securities denominated in a foreign currency present a question regarding the dollar cost basis of the securities whether the securities are purchased in a foreign account or a domestic account.

If securities are purchased in a foreign account (and are sold while still held in that account), then no gross proceeds or cost basis reporting will occur. If securities purchased in a foreign account are later transferred to a domestic account, then a question arises whether to capture cost basis information at the time of the transfer regardless of whether the securities are denominated in dollars or in a foreign currency.

2. Applicable law. Sec. 985(b) provides that the functional currency of a taxpayer other than a "qualifying business unit" ("QBU") is the dollar. This statutory rule is elaborated by Treas. Reg. 1.985-1(b)(1)(i) which provides that the dollar is the functional currency of "a taxpayer that is not a QBU (e.g. an individual)." Accordingly, for U.S. tax purposes

[10] The acquisition of a foreign currency denominated debt instrument is typically a Sec. 988 transaction, while acquisition of foreign stock is not. See Sec. 988(c)(1)(B)(i).

all individuals have a dollar functional currency, regardless of their citizenship or residence.

Under Treas. Reg. 1.988-2(a)(2)(iv), the cost, basis and amount realized as a result of nonfunctional currency purchases and sales of stock and securities traded on an established securities market are based on the spot price as of the settlement date even if gain or loss is measured at a different date. This treatment is mandatory for cash basis taxpayers and elective for accrual basis taxpayers. For transactions effected through a domestic account, the foreign currency will often be purchased or sold on the same day as the settlement date for the purchase or sale. In that case, the dollar cost of the currency purchased or the dollar proceeds of the currency sold should be used as the relevant cost or proceeds of the securities. See Treas. Reg. 1.988-2(a)(2)(iv)(C)(Example). Otherwise, a published spot rate would be used. See Treas. Reg. 1.988-1(d). For domestic accounts, the broker should be expected to capture the dollar basis and dollar proceeds information in connection with effecting the transaction.

Transfers of securities from foreign accounts to domestic accounts present more difficult questions. Foreign and domestic taxpayers transferring securities from foreign non-dollar denominated accounts to a domestic account are likely to have data that reflects cost in a non-dollar currency. They may or may not have specific information regarding the date of purchase. Nevertheless, we recommend that the broker solicit purchase settlement date and cost information when securities or transferred from a foreign account to a domestic account of an individual. If the information is provided, then the broker should determine the dollar cost basis for exchange traded securities in such accounts using settlement dates in the manner described in Treas. Reg. 1.985-1(b)(1)(i). A broker should also be permitted to use the "purchase date" provided by the taxpayer even if it is not clear that the date provided is the settlement date. The broker should also be permitted to specify on its cost basis information return that it is relying on information provided by the taxpayer and, if the taxpayer has not provided information, that cost basis reporting is being omitted for that reason.

We note that foreign currency related securities transactions can raise additional complexities that could impact the determination of basis, particularly with regard to debt instruments and OID. See, e.g., Treas. Reg. 1.988-2(b)

Transfer Reporting

21. What information about the transferring person, the customer, the security transferred, and the underlying lots should be required on the transfer reporting statements;

RECOMMENDATION:
A transferring broker should provide the following information electronically in a standardized format to the receiving broker:

FOR EACH TAX LOT (after dividing such lots to take into account wash sale adjustments) OF EACH SECURITY TRANSFERRED:

Account ID
Lot ID
Effective Date (Transfer Date)
Original Purchase Date
Holding Period (adjusted for tacking and other adjustments)
Security Identifier
Security Type
Units (Shares, contracts, bonds)
Original Cost
Basis Adjustment (any applicable/required basis adjustment)
Lot Relief Method/Elections (Averaging/Single Acct Election)
Origin Source
Reportable
Short/Long
Original Transaction Type
Date of Last Corporate Action Adjustment Prior to Transfer
Position Identifier
Covered/Noncovered Security
Effective Date of Latest Corporate Action
Wash Sale Deferral (Y/N)
Unclearly Defined Transfer Indicator

We believe that this level of detail is generally necessary and useful in order for brokers to accurately compute cost basis and required adjustments for corporate actions and wash sales for covered securities.

DISCUSSION:
In order to permit the receiving broker to make proper determinations for cost basis reporting purposes, there are a number of items of information that the transferring broker should provide. Some of them may be obvious. However, others are not.
For example, basic information such as purchase date, price per share plus any related capitalizable costs such as commissions for each tax lot for each transferred security would be necessary. This basic data would provide the tax lot structure needed by the

receiving broker to correctly compute basis for cost basis reporting purposes when the transferring customer's shares are later sold.

A tax lot is generally established when a particular block of shares is acquired by purchase. Each share in the block or lot has the same basis, the same allocable portion of commission costs and the same initial holding date. However, merely transferring the details of a customer's holding based on tax lots determined by purchase is inadequate. It is necessary that each tax lot could be further sub-divided into smaller portions that could be referred to as tax sub-lots as a result of wash sales. The wash sale rule requires that in computing wash sale loss deferrals and in determining subsequent adjustments to the basis and holding period of the loss triggering shares due to deferred losses that only an identical number of shares are affected. See Sec. 1091(b) and (c) and Treas. Reg. 1.1091-1(c) and (d).

For example, assume that a taxpayer holds one tax lot comprised of 100 shares of Acme common stock with a basis per share of $10 that was acquired on January 1, 2009 and then sells 50 shares of the lot at $8 per share on July 1, 2009 (resulting in a $2 loss per share). Assume further that the taxpayer then purchases a second tax lot of 70 shares of Acme stock on July 30th, 2009 at a price of $8.50 per share. This purchase will trigger the wash sale rule and the entire loss on the sale of 50 shares on July 1, 2009 will be deferred. Due to the application of the wash sale rule provisions relating to the number of shares sold and purchased, the taxpayer will have at least two tax lots: the Jan. 1, 2009 tax lot with a remaining balance of 50 shares and the July 30th, 2009 tax lot with a balance of 70 shares. However, the deferred loss and holding period adjustments resulting from the wash sale will only affect a portion—i.e., 50 of the shares purchased on July 30th (hence, the term "sub-lot") of the July 30th tax lot. Thus, the July 30th tax lot will essentially be divided into two portions: a 50 share portion that carries the deferred loss basis adjustment and holding period adjustment associated with the wash sale and a 20 share portion that just includes the remaining 20 shares with a basis of $8.50 per share and holding period beginning on July 31st, 2009 that does not take into account the referenced wash sale related adjustments. Thus, a more accurate categorization of the remaining tax lot structure in the example would be three distinct tax lots: tax lot 1 (50 Acme shares acquired in original purchase that remain after reduction for shares sold); tax lot 2 (50 Acme shares in the subsequent purchase that are affected by wash sale deferral adjustments); and tax lot 3 (20 Acme shares in the subsequent purchase portion that were unaffected by the wash sale).

Additional divisions into distinct portions or sub-lots can arise when additional wash sales or purchases occur. In order for a receiving broker to properly apply the basis and holding adjustments relating to wash sales when transferred shares are subsequently sold, the tax lots must be divided into the portions that were affected by a specific wash sale and those that were not (the tax sub-lots). Thus, the transferring broker must maintain and provide tax lot detail to the receiving broker based on sub-lots that take into account wash sale adjustments rather than merely the larger tax lots based on the original purchase amounts of shares.

For broker processing efficiency, it would also be useful if the transferring broker identified the particular lot relief method (first-in/first-out, specific ID by identified lots or by method such as highest-in/first-out, or single or double category averaging if applicable) last used for each transferred security. This would facilitate cost basis related computations by the receiving broker. This information would also be necessary if certain lot relief methods such as averaging methods are generally irrevocable once elected for or by a customer.

Corporate action related cost basis adjustments could create their own issues that necessitate the transfer of additional information. It should be noted that all brokers do not make basis adjustments relating to corporate actions at the same moment in time in some sort of synchronized way. Depending upon internal processes and systems, one broker may book the same corporate action at a different time or on a different date than another broker. There is a risk that a transferring broker could have made a corporate action related basis adjustment on the day before the transfer even though the receiving broker may be booking the same adjustment the day (or moment) after the transfer. A transferring broker could identify the date of the last corporate action booked relating to each security transferred to assist the receiving broker in determining whether it has or must make a pending corporate action adjustment to securities received.

The receiving broker may need other critical information relating to wash sales. For example, if a transferred tax lot had triggered a prior wash sale loss deferral, a wash sale deferral will be associated with that lot that must be taken into account when the transferred (wash sale loss deferral triggering) lot is subsequently sold. See generally Sec. 1091(d) and Treas. Reg. 1.1091-2(a). A related wash sale holding period adjustment must be made to such transferred tax lot—the holding period of the security sold at a loss, which was deferred due to the wash sale rule, tacks on to the transferred (wash sale loss deferral triggering) lot. See Sec. 1223(3). Thus, the information relating to each tax lot should correctly reflect these adjustments or such adjustments should be separately stated. The amount of other basis adjustments would also need to be separately retained to separate such information from historical acquisition cost.

Under the wash sale rule, a tax lot cannot simultaneously trigger multiple wash sales. See Treas. Reg. 1.1091-1(e). Thus, if a tax lot has triggered a wash sale, this fact should be communicated to the receiving broker so that such tax lot cannot trigger another wash sale that would violate this limitation. The purchase date or identity of the tax lot must also be retained because the disposition of a portion of a tax lot within 30 days after the date of purchase cannot trigger a wash sale with respect to the purchase of such tax lot. See Rev. Rul. 56-602, 1956-2 CB 527.

The definition of covered securities, the tiered effective dates for different security types, and the differing rules regarding available lot relief methods for mutual fund and DRIP shares also require additional information in connection with the transfer of securities. It would be helpful for the transferring broker to provide security type information (i.e., stock, mutual fund or DRIP stock, debt instrument, option or other covered security type including those established under future IRS guidance) so that a receiving broker can

determine whether transferred securities are subject to cost basis reporting and determine the applicable effective dates. Also, the transferor should identify whether the transferred security positions are short or long because of the different substantive and reporting tax rules applicable to short sales. See, e.g., Secs. 1091(a), 1091(e) 1233 and 6045(g)(5).

Some securities transferred may have previously been received by the transferring broker without cost basis information. This could have occurred because the securities were grandfathered and excluded from the definition of covered securities because they had originally been acquired before the applicable effective dates. Alternatively, the securities could have been received from a prior broker that failed to provide the required cost basis transfer statement under Sec. 6045A. Or the securities could have been transferred to the broker from a person who is not a broker and who is not obligated to provide cost basis information. It could be difficult for a transferee broker to explain why it believed it was not required to provide cost basis information regarding securities it holds if it simply receives a transfer without any accompanying explanation for the absence of cost basis information. The transfer of acquisition history information relating to securities that were transferred to the transferring broker could be important to the receiving broker in defending its basis for not providing cost basis information for certain transferred securities or in addressing issues relating to the correctness of such information.

Securities may be recorded to a customer's account for a variety of reasons. Some securities are acquired by purchase. Other securities are transferred due to gift or inheritance. Some securities are transferred from one customer account to another. In other cases, securities may be transferred to the account from a third party—either a broker or another person that does not constitute a broker for Sec. 6045 purposes. The nature of the transfer may affect whether a broker is obligated to provide cost basis reporting in connection with the disposition of such securities. Thus, it would be useful for the transferring broker to provide the receiving broker with information regarding the original transaction type that resulted in the deposit of each security into the related customer account of the transferring broker. In certain cases, the circumstances of the transfer may be unclear or incomplete and a marker to that effect could also provide an important record.

22. Whether fifteen days is the proper period for furnishing transfer reporting statements, and under what circumstances a different time period, if any, should apply;

RECOMMENDATION:
Brokers should be encouraged to provide cost basis information as soon as possible after securities are transferred (such as by the close of the next business day after the date of the transfer) due to the potential difficulties with reconciling information received later with intervening events and transactions. However, we do not believe such a rule should be mandatory until it is clear that brokers systems are generally able to meet such a requirement. We believe that there may be extenuating circumstances that justify relief

from the transfer reporting deadline in certain limited cases. However, every exception delays the ability of the receiving broker to subsequently provide cost basis information regarding the transferred securities. We believe that a different standard of reporting should apply to non-brokers that are subject to Code Sec. 6045A reporting and that do not regularly provide transfer reporting information to brokers below a to-be-determined level of activity. The IRS should also develop rules to address cascading transfers and their potential impact on compliance with the timely delivery requirement for transfer information under Sec. 6045A.

DISCUSSION:
It was assumed that the 15 day period established in Sec. 6045A(c) was based on the 15 day delivery protocol of CBRS—the cost basis reporting service offered by DTCC. It would seem reasonable that a broker should have some time to prepare the necessary cost basis information that it would transfer to a receiving broker in connection with the transfer of a customer's securities from one broker to another. However, brokers ordinarily try to reconcile their customer's accounts on a nightly basis, relying on batch processing systems to do much of the necessary updating. Moreover, brokers are evaluating or considering updating various systems to provide real time processing of customer activity. A broker might desire the receipt of cost basis information received from a transferring broker quickly—such as by the next business day, so that the receiving broker's cost basis records can be kept up to date. Otherwise, it would be necessary to go back and account for events that occur between the date of transfer and the date of receipt of cost basis information. Such retroactive adjustments could be troublesome and potentially expensive for some brokers accounting systems.

In spite of the need for uniform timeliness of basis information in connection with securities transfers, we note that on occasion brokers systems may go down. The IRS should consider penalty relief if such failures result in untimely reporting provided that they are due to extenuating circumstances. However, recurring delays by a broker or multiple brokers in providing timely reporting of such information could have a substantial adverse affect on broker basis reporting. Thus, any such relief should be limited.

Because the transfer reporting rules can apply to person other than brokers, it may be necessary for the IRS to establish different rules for non-broker persons subject to Sec. 6045A reporting. Some such persons may not have the volume of activity to provide the necessary information as quickly and in the same format as brokers.
There are also cascading difficulties with any delay of information. For example, what if customer transfers her account from broker A to broker B on January 15, 2012 and then transfers her account from broker B to broker C on January 20, 2012? Should broker B be required to provide broker C with cost basis information regarding the transferred securities within 15 days after the date of the transfer (February 4, 2012)? What if broker B only receives information from broker A regarding the securities transferred to it on January 30, 2012?

23. Whether the basis determination rules and customer elections governing sales of securities should apply equally to transfers of securities, for example, when a customer transfers some, but not all, holdings of a security to another broker;

RECOMMENDATION:
Yes, the basis determination rules and customer elections should apply when a customer transfers some but not all of her securities to another broker.

DISCUSSION:
The cost basis reporting rules amend Sec. 1012 to provide that lot relief methods are applied on an account by account basis rather than across a taxpayer's entire holdings (and possibly the holdings of a spouse in the case of jointly filed returns). This change was presumably made to address cost basis systems limitations that made the application of lot relief methods and customer elections difficult to manage if data outside of a specific account or outside of the knowledge of a customer's broker needed to be taken into account.

Other than with respect to basis averaging, because current law and Sec. 6045(g)(2)(B)(i)(I) generally permits a taxpayer to freely select specific identification (or default to first-in/first-out), the selection of a different lot relief method on the transfer of some securities to another broker does not appear to permit a taxpayer to do something through a transfer that could not be done directly. With regard to basis averaging for mutual fund and DRIP shares, a similar analysis of the taxpayer's options depends on the manner and timeframe in which the fund or broker can select averaging, the taxpayer can elect out, and whether either such election is irrevocable.

24. Whether electronic transfer reporting may be appropriate and, if so, whether a common format should apply;

RECOMMENDATION:
Information should be provided electronically rather than on written or printed statements. It should be standardized to facilitate processing. Although transfer reporting can apply to non-brokers, we believe that electronic reporting would still be necessary to accommodate the input of the information into broker systems.

DISCUSSION:
Broker customer accounting systems, including those currently including cost basis information, are computer based systems. Electronic transfer reporting is strongly preferred over written statements because such reporting is easier and cheaper to process. It is also less prone to error. The information should be standardized in a format that can be readily converted to integrate with each broker's accounting system.

25. Whether brokers and transferring parties may utilize reporting services of third-party intermediaries to meet their transfer reporting requirements;

RECOMMENDATION:
Brokers should be able to utilize the reporting services of third-party intermediaries for cost basis transfer reporting purposes without limitation.

DISCUSSION:
Brokers and other security market participants use a number of different vendors and third party services in connection with the processing of trades, the maintenance of their order management and customer accounting systems and tax reporting. We believe that this is done because it can be more efficient and cost effective for brokers to rely on vendors and third parties in many cases. There is no apparent policy reason why they should be prevented from utilizing reporting services of third-party intermediaries for cost basis transfer reporting purposes.

26. Whether the transferring person should communicate any information or justification to the transferee broker when no transfer reporting statement is required because the security is not a covered security;

RECOMMENDATION:
Yes. We believe that in order for Sec. 6045A to work for the transferee, a document should be received from the transferor in all cases, even for noncovered securities. The transferring person should explain to the transferee when no transfer reporting statement is required because the security is not a covered security. The information that we believe should be provided in connection with transfers would address this issue. See our comment to Notice Issue No. 21.

DISCUSSION:
The IRS could review the adequacy of cost basis reporting in connection with an audit or the assessment of penalties relating to information returns. Such a review could occur several years after the year of transfer. It is often difficult to prove a negative. If a broker does not retain information regarding whether certain securities were received from another broker and information regarding whether any such transferred securities were not covered securities as determined by the transferring broker, it could be difficult for the receiving broker to independently make such assessments itself at the time of the review.

Issuer Reporting

27. What information about the issuer and organizational action should be required on the issuer returns and reporting statements;

RECOMMENDATION:
We recommend that the primary mechanism for issuer reporting should be a public reporting system relying on the current open network of corporate action reporting services and the required delivery to the public of facts and key tax information by issuers, as discussed below. A public reporting regime can require that more comprehensive information be provided and may also require that it be made available in accordance with a universal classification system that will facilitate its usage by market participants. It would also seem more flexible in responding to changing market needs. We believe that certain issuer information should be required to be provided in a format that is essentially dictated by such a reporting regime in order to provide standardized tax information that is detailed enough to permit the necessary corporate action related basis adjustments for covered securities. We recommend that issuers be required to deliver disclosure statements setting forth a discussion of the relevant tax issues, whenever possible, or at least provide sufficient facts to allow a broker to make a reasoned determination of the tax consequences of a corporate action affecting basis under a three-tiered approach. We believe that issuers should not be required to provide precise mathematical computations of adjustments to basis because it would seem to replicate the task of brokers and would be problematic given the differences in facts, valuations and allocations that could apply to different customers of a broker due to their particular circumstances. Such a public reporting system could also serve as an important archive regarding historical corporate actions for brokers and other market participants, particularly given that issuers can regularly consolidate or go out of existence. We also believe that both issuers and the IRS could save both initial and ongoing costs by relying on a public reporting system rather than a form based reporting system. We also recommend that privately issued specified securities should not be subject to issuer reporting under Sec. 6045B or broker basis reporting under Sec. 6045(g) unless and until the IRS has considered the appropriate rules for both issuers and brokers under the cost basis reporting law.

DISCUSSION:
Sec. 6045B(a) provides general guidance regarding the information about the issuer and the organizational action that should be required on issuers returns and reporting statements. It requires "(1) a description of any organizational action which affects the basis of such specified security of such issuer, (2) the quantitative effect on the basis of such specified security resulting from such action, and (3) such other information as the Secretary may prescribe." Sec. 6045B(a).

1. Description of organizational action. The description of an organizational action affecting basis could take many forms. Corporate actions routinely occur daily and have occurred for probably as long as securities have been issued by business organizations and sold to investors. Narrative descriptions of corporate actions prepared by issuers and

their advisors can vary widely. In order to efficiently track corporate actions for the broad universe of investor held securities, brokers typically rely on corporate action reporting services, market information services and internal corporate action reporting personnel. Over time, key information items regarding the details of a corporate action have developed and intermediaries and internal specialists have reviewed documents prepared and publicly released by the issuer (generally in response to securities regulatory or market rule requirements) and have extracted, summarized and standardized such information.

To assist brokers and others in handling corporate action information, a basic classification system should be established that would likely be comparable to that currently used in corporate action reporting. Such a system would be similar to the classification system used in many document management systems. For example, an issuer would identify the basic nature of the corporate action (corporate reorganization, merger, asset purchase, check the box/liquidation, tender offer etc.), the securities affected (by CUSIP number or other common market identifier), and the overall tax treatment. See Sec. 6045B(a). However, given that such information is already being assimilated for those issuers that provide it and is standardized by corporate action reporting services and others in a manner generally acceptable to brokers, the question arises as to whether the implementation of an alternative return based system is duplicative and unnecessarily costly. This last point will be addressed in more detail below regarding whether a public reporting regime would be a preferred alternative.

2. Quantitative effect on basis.
Sec. 6045B(a)(2) requires the issuer to report "the quantitative effect on the basis of such specified security resulting from such action..." The critical issue is what it should mean to report the "quantitative effect on basis."

a. Possible lack of clear tax opinion from issuer. Currently, not all issuers report on the tax consequences of corporate actions (especially foreign issuers) and even when they do, the reporting is not always definitive. For example, even though an issuer may report to investors and the market participants referenced earlier information regarding a pending or completed corporate action, the issuer provided information may not include a tax opinion regarding the federal income tax consequences to holders of the corporate action. Or the issuer may provide a tax opinion that is inconclusive or incomplete. For example, it may provide two possible alternative set of tax consequences to investors with no clear guidance as to which alternative is more likely. The lack of a tax opinion or the presentation of different possible alternatives with no guidance as to the more likely alternative forces brokers to guess at the appropriate tax treatment, sometimes without adequate facts to make a reasoned decision . In many cases, the issuer presumably has access to facts about the corporate action that would have a direct bearing on taxability, but does not disclose them. Because brokers are essentially left to their own devices, the tax treatment that each selects to apply to the security can be different. For example, in connection with a spin-off corporate action for which no tax opinion is provided, the issuer may not disclose historical business facts that could be relevant to a holder in concluding that the action does not qualify as tax-free under Sec. 355.

As a policy matter, we believe that different investors holding the same security through different brokers should generally report the tax consequences of a corporate action in the same fashion. We believe that the requirement for an issuer to report the quantitative effect was intended to address this issue.

It should be noted that the substantive tax law regarding the principal tax consequences to holders may not be clear in various cases and the cost basis reporting law does not include any provisions that change substantive law regarding corporate actions or make such determinations easier. The lack of clear guidance under the substantive law governing the tax consequences of a particular corporate action is one reason why an issuer may not be willing to provide a tax opinion on a corporate action or may choose instead to state the legal consequences in the alternative without taking a firm position. However, it seems obvious that the issuer of the security is generally in a relatively better position than investors to assess the relevant facts for making such tax determinations.

To address this issue, we recommend a two tiered approach: First, we believe that with respect to each issuer of covered securities in connection with a corporate action, such issuer should be required to provide a "most likely" tax disclosure statement addressing the tax consequences of a corporate action to holders of such securities and setting forth the most likely outcome (if multiple alternatives are presented) but only if the issuer can provide such a statement based on then applicable facts and law. Such a statement could set forth the relevant facts and stating its view as to the most likely outcome based on a lower "reasonable efforts" standard of evaluating then applicable facts and law. Two, in each case where the issuer is unable to provide such tax consequences disclosure statement, the issuer should provide a tax information statement (rather than such opinion or disclosure statement) setting forth a summary of the then relevant facts (as well as any facts that might be relevant after the corporate action becomes effective) and law that were material and considered in its assessment of the tax consequences of the corporate action.

Facts that might be relevant for investors after the fact include, for example, the total number of shares outstanding after a redemption, or the percentage of shares taken up in a stock-for-stock exchange (which might be necessary to meet the control requirement under Sec. 368), or the anticipated earnings and profits of the issuer. See, e.g., Alberto-Culver Co. $25 special dividend paid on 11-26-2006 which included a warning that the issuer expected the amount of the distribution to exceed its earnings and profits, but that it would not be able to determine how much of the distribution should be treated as return of capital (resulting in a reduction of basis or capital gain) until 2008.

b. Reportable tax consequences. Generally, a tax opinion provided regarding the tax consequences of a corporate action to holders sets forth the basic tax treatment. For example, in a corporate action involving the exchange of old securities for new securities in a corporate reorganization, the tax opinion may essentially provide that the exchange is taxable (capital gain or loss determined by subtracting the basis of the old securities from the fair market value of the new), taxable to the extent of cash or boot received (see the

boot rule of Sec. 356(a)(1)), nontaxable (under Sec. 354) or taxable as a dividend (see Sec. 356(a)(2)). Understanding this basic tax treatment is essential to correctly booking the tax consequences of the corporate action. Note that the precise wording of the tax opinion is likely to vary from one opinion to another. It is this basic tax treatment that we believe should be reported under Sec. 6045B under the two-tiered approach set forth above.[11]

In addition to the basic tax treatment of the corporate action, it is typical for corporate tax opinions to address certain other potential tax consequences that may be material to typical holders of the related securities. For example, federal income tax law includes rules that can result in differing treatment to taxpayers resulting from corporate actions based on the level of ownership of the issuer of the related securities. See, e.g., Secs. 302 & 304. We also note that tax treatment could differ for holders based on whether the holder is a nonresident. See, e.g., Sec. 1441. We recommend that such information also be required to be disclosed, either pursuant to Sec. 6045B(a)(2) or (a)(3).

Further, tax consequences may vary based on the nature or individual circumstances of the shareholder. Tax opinions provided by issuers in connection with a corporate action typically limit their discussion to certain types of shareholders such as those that hold their stock as capital assets, and specifically exclude shareholders with special circumstances, such as shareholders that hold 5% or 10% of the issuer's stock, persons whose functional currency is not the U.S. dollar, persons that hold the stock as part of a straddle, hedge or constructive sale or conversion transaction, individual retirement and other tax-deferred accounts, U.S. holders that acquired their stock through the exercise of an employee stock option or otherwise as compensation, etc. Disclosure of such limitations should be made.

c. Quantitative effect on basis versus basis adjustments. It is a longstanding practice of brokers to adjust the basis of their customers' holdings as a result of corporate actions. The precise adjustments for each customer's securities resulting from a single corporate action generally varies from customer to customer. This can be the result of the different sizes of customer's holdings as well as a result of different customer elections (cash versus stock) for certain types of corporate actions. It can also be the result of different customer circumstances, such as the analysis of the consequences of a redemption governed by Sec. 302 when different holders hold different percentage interests in the issuer, either directly or through attribution. There can also be differences in the precise date distributions are received by certain holders as well as differences in determinations of the market value or exchange rate of consideration received. For example, an issuer may or may not provide estimates of fair market value for purposes of computing basis

[11] For some issuers, the assessment of whether an issuer of securities is or has been a passive foreign investment company ("PFIC") under Sec. 1297 could result in corporate actions that would otherwise be routine triggering significant adverse consequences to holders. Such assessments are factually difficult but the IRS should consider the potential impact of uncertainty regarding PFIC status on an issuer's Sec. 6045B reporting obligation, as well as on brokers and holders of the related securities. We note that currently some issuers provide PFIC status information in connection with corporate actions while other issuers do not. However, foreign issuer reporting raises jurisdictional concerns and as discussed below, we recommend further study. See our comments in response to Notice Issue No. 29.

adjustments due to a spin-off of shares. Corporate action reporting services and brokers often use their own valuations and compute their own allocations that they might believe are more appropriate, conservative or tax accurate. And, as noted elsewhere in our comments, brokers do not all process corporate action basis adjustments relating to a single corporate action at the exact same time. This may be due to internal review procedures as well as systems processing limitations or procedures.

We do not believe it was intended that the issuer of covered securities would be required to provide the precise amount of basis adjustments for covered securities resulting from a corporate action that took into account all of the potentially relevant facts. Instead, we believe that providing the tax opinion information and additional tax consequences information described above reflects the intended scope of the "quantitative effect on basis" requirement and we recommend that the IRS clarify this in its guidance.

3. Other information as prescribed.
We believe that this open-ended requirement was intended to permit the IRS to require issuers to provide other information that may be necessary or useful to brokers in processing corporate action related basis adjustments. Precisely what additional information would be appropriate is unclear.

It could be important to require issuers to subsequently provide any post-event facts or information that might have a material bearing on the tax consequences of the corporate action to holders and the impact on cost basis. Such post-event information could include, for example, number of shares outstanding after a redemption offer (for Sec. 302 purposes), number of shares taken up in a stock-for-stock exchange offer, date on which a security is sold for the benefit of shareholders, amount realized, etc. (as discussed below regarding ADRs), updates or estimates regarding earnings and profits (even before the end of the issuers fiscal year – perhaps at the end of each quarter). Such material post-event information should be reported or made publicly available as soon as possible after it is known to the issuer. For example, in Alberto-Culver, the updated tax characterization of the $25 special dividend was not reported in a press release.

As discussed above, corporate action reporting services and other market information services provide a range of additional information of use to brokers and other market participants. It would be possible to review the additional information relating to corporate actions currently provided and the IRS could develop a list based on its review of market practices in this regard. However, we recommend against such an approach. As discussed above, given that such information is already being assimilated for those issuers that provide it and is standardized by corporate action reporting services and others in a manner generally acceptable to brokers, the question arises as to whether the implementation of an alternative return based system that simply incorporates a list of such additional information is duplicative and unnecessarily costly. In addition, it has been our experience that additional information requested by brokers and other market participants has evolved over time. Some of the new information requested has been based on changes in technology and market and intermediary practices. Other information has or could become relevant due to changes in tax law. A list based

approach would require the necessary monitoring of such matters to determine whether it would need to be updated. The market and the information providers have essentially been doing this already.

4. Private Issuers.

We note that unlike some earlier cost basis reporting proposals, the issuer reporting requirement of Sec. 6045B and the definition of covered securities under Sec. 6045(g) do not exclude issuers or securities relating to privately issued securities that are not subject to ongoing SEC regulatory reporting requirements. The implicit inclusion of such issuers and securities within the scope of broker's cost basis reporting obligations further justifies the need to require corporate action reporting by such issuers. However, it creates practical problems that will likely require the development of special rules for issuers, brokers and other applicable persons relating to the potential cost basis reporting for such securities.

For example, private issuers may have limited resources to provide required reporting information for Sec. 6045B reporting. And, brokers and other market intermediaries and information services may have a more difficult time obtaining facts necessary to independently assess the potential tax consequences of corporate actions relating to such securities.

Given that there were recent proposals to exclude privately issued securities from the cost basis reporting rules, it could be inferred that the failure to explicitly exclude such securities from the cost basis reporting rules as enacted was intended. Regardless, we recommend that the IRS exclude such securities from the definition of covered securities unless and until guidance is issued regarding the corporate action reporting relating to such securities under Sec. 6045B.

5. Public Reporting Regime.

Sec. 6045B(e) provides for public reporting in lieu of return. The provision states that the IRS "...may waive requirements under [Sec. 6045B] with respect to a specified security, if the person required to make the return...makes publicly available, in such form and manner as the Secretary determines necessary to carry out the purposes of this section..." Note that that IRS can dictate both the form and manner of acceptable public disclosure in lieu of the issuer's obligation to file returns and deliver statements to holders. Hence our reference to this rule as a public reporting regime.

A public reporting regime could take a variety of approaches in delivering needed corporate actions information from issuers to holders of specified securities. For example, such a regime could provide that an issuer would be exempted from the Sec. 6045B return filing and statement delivery obligations if and only if the issuer provides IRS specified information regarding the corporate action and its effect on basis otherwise required to be included in the return. The IRS could provide that the timely public dissemination of such information in a press release or on an issuer website accessible by the public would satisfy the public reporting requirement. In the absence of conforming public reporting, the IRS could require the issuer to file the form and provide the issuer

corporate action reporting statement to holders. Such an approach presents several concerns. First, it would necessitate the development and maintenance of IRS systems to process such returns which could be burdensome and expensive. Second, there could be concerns by brokers regarding the acceptability and accessibility of the information. For example, the manner of reporting such information by issuers might not be uniform. This is currently the case regarding the existing reporting of corporate actions and their tax consequences to the market. Thus, the existence of corporate action reporting systems and broker staff dedicated to corporate actions processing. It might also be difficult for brokers and other intermediaries to find the needed information, which could be problematic. For example, assume that a company changes its name and issues new shares in substitution for shares under the old name. Should the broker look for a website under the new company name or the old name? Similarly, will the information be available if the issuer goes out of business or is merged out of existence? These sorts of issues are the reasons why corporate action reporting services emerged as important resources for brokers in their current processing of corporate actions.

We believe that a public reporting system relying on the delivery of required information of the kind set forth above to corporate actions reporting services and brokers is another acceptable form of public reporting that could constitute a public reporting regime given that Sec. 6045B(e) permits the IRS to dictate the manner of public reporting. We are not advocating the establishment of a single reporting service that would act as a central repository but we acknowledge that such an option could be used. Instead, we believe that the existing open system of corporate action reporting services that provide such information to brokers, and the public availability of the underlying facts and tax information specified above to such systems and the public, could address the needs of brokers relating to adjusting reported basis for corporate actions under the cost basis reporting law.

We believe that such a public reporting system would provide greater certainty that the issuer reporting of the critical tax information relating to corporate actions would become standardized. This would also promote consistent treatment.

28. How to maximize the timeliness of issuer returns and statements and promote public reporting by issuers in lieu of return filing;

RECOMMENDATION:
We recommend that the IRS consult with the SEC and other regulatory bodies in its development of a public reporting regime. As described above in our comment on Notice Issue No. 27, that regime should put the burden on issuers to make corporate action information generally available to affected parties through corporate action reporting services and public dissemination rather than simply allowing the information to be posted on an issuer's web site. We anticipate that application of the securities law timeliness requirements for required public disclosures by issuers of public debt will be sufficient to ensure timely availability of corporate action information affecting cost basis adjustments.

DISCUSSION:
If the corporate action information is to be integrated into the cost basis information reported by brokers, it is essential that the corporate action information be made available to brokers and other market participants including corporate action reporting services on a timely basis. Sec. 6045B(c)(statements to holders or their nominees) provides for the information to be given to brokers, but with a statutory deadline of January 15 of the calendar year following the year of the corporate action. Sec. 6045B(b) curiously sets an earlier deadline for the required return to the IRS, which is no later than the earlier of 45 days after the date of the action or January 15 of the following calendar year. But that return is not necessarily publicly available. In any event, permitting issuers to delay providing information to brokers for even the shorter period specified for the return to the IRS would present serious practical problems for transfers of securities that occur during that period. As discussed earlier, brokers generally attempt to update customer records on a daily basis. For assistance, they generally rely on corporate action reporting services that summarize relevant tax information relating to corporate actions, including discussion and analysis. The receipt of tax information necessary for making corporate action related basis adjustments after such updating cycle increases the cost and systems burdens to brokers. Accordingly, we recommend that IRS exercise the authority in Sec. 6045(e) to establish a shorter deadline by waiving the requirements in Sec. 6045(a) & (c) if the issuer makes the required information publicly available (as discussed below) contemporaneously with the corporate action.

We further recommend that the approach taken with respect to issuer reporting of corporate action information should consider existing and possible future public disclosure relating to corporate actions for specified securities under other applicable federal regulations and possibly involve consultation with the Securities and Exchange Commission or other interested regulatory body. Many issuers (including foreign issuers that sponsor American Depositary Receipt ("ADR") programs) are subject to SEC reporting requirements with respect to significant corporate actions, and the time, manner and content Sec. 6045B corporate action reporting could take advantage of any existing or subsequently required SEC reporting. Another reason for consultation is that a rule requiring issuers to publicly report corporate actions affecting only privately placed securities could present concerns regarding the private placement status of those securities.

We note that development of Sec. 6045B reporting requirements in consultation with SEC reporting requirements may be a way of achieving mandatory public reporting of Sec. 6045B information in a manner that will have broad issuer acceptance through minimization of additional administrative burdens.

For example, one big challenge for ADR holders is foreign companies that undertake a corporate action in the home country. See, e.g., Anglo American plc distribution of Mondi plc ordinary share and Mondi Ltd. ordinary shares on 7-2-2007, where both distributions had a direct impact on basis, but ADR holders received cash proceeds from the sale of the stock. We recommend that the U.S. depositary be required to provide

additional information, such as date of receipt, date of sale of a security, amount of proceeds realized in local currency, date and the exchange rate used for converting currency into US dollars. This would help ADR holders to make important determinations about taxability and basis. Another example would be a Brazilian company that issues preferred shares as their primary capital markets funding mechanism. Depositaries could be required to provide information that would help investors determine whether the underlying shares should be treated as preferred shares for purposes of Sec. 305 or as common stock.

29. How to account for basis-changing organizational actions by foreign issuers of securities to the extent that foreign issuers are not subject to the issuer reporting requirements;

RECOMMENDATION:
We recommend that the treatment of corporate actions by foreign issuers not subject to Sec. 6045B be treated as a separate project.

DISCUSSION:
This question illustrates how the enactment of cost basis reporting requirements has provided a new perspective for viewing existing problems. U.S. taxpayers may invest in foreign securities, and the cost basis for those securities may be affected by corporate actions. A uniform approach to adjustments for those corporate actions could be beneficial for taxpayers and tax administrators alike. But the new cost basis reporting regime may not provide a solution if the issuer is not subject to Sec. 6045B. Nevertheless, implementation of the cost basis reporting regime may provide a needed catalyst for separate action, as otherwise foreign securities will constitute either a gap in the information reporting regime or a source of potential errors.

Many large institutional investors now invest in foreign securities. According to the Investment Company Institute, in 2007, U.S. residents purchased $252 billion in foreign stocks and bonds, and mutual funds and ETFs accounted for most of these purchases. These institutional investors likely receive corporate action information and adjust their cost basis in the securities based on their understanding of the information received. U.S. individual investors also appear to be investing in foreign securities through their brokers. Although information relating to the U.S. federal income tax treatment of corporate actions for foreign securities may be scant, it is inescapable that both institutional investors and brokers for individual investors holding foreign securities must adjust their holdings for related corporate actions. If the U.S. tax treatment is unclear, some brokers and institutions may be relying on internal resources to make their best assessment in the absence of guidance, turning to corporate action reporting services that provide coverage of foreign markets and foreign securities or doing nothing (treating such actions as non-taxable). These adjustments are probably "under the radar" now and may not be a priority area for IRS review. But the area could benefit from greater transparency accompanied by reduction in uncertainty and inconsistent treatment by similarly situated investors holding identical securities A possible first step would be to

establish rules for public reporting similar to those described above for such corporate action information. Consideration could then be given to a rule that the IRS would accept certain basis adjustments when the taxpayer has a reasonable basis for the position taken, unless it gives notice to the contrary. A possible model for this procedure would the reliance procedure under Sec. 170 respecting charitable status.

30. How to coordinate broker transfer reporting with issuer corporate action reporting to avoid duplicate broker adjustments when accounts are transferred and whether a universal timing standard should apply;

RECOMMENDATION:
We recommend that as an initial approach, the private sector should be encouraged to adopt a uniform protocol for timing the capture of corporate action information with respect to transferred securities. However, real time synchronicity may be difficult to achieve and is unlikely by the time cost basis reporting becomes effective. In addition, corporate action reporting can be subject to subsequent updating after the date of the corporate action event. Thus, we recommend that a transferring broker identify the date of the last corporate action booked relating to each security transferred to assist the receiving broker in determining whether it has or must make a pending corporate action adjustment to securities received.

DISCUSSION:
In our response to Notice Issue No. 21 we noted the problems that can arise with respect to transferred securities if the transferor and transferee brokers capture corporate action information at different times. The potential for omitted or duplicated adjustments could be exacerbated under a return-based approach to issuer reporting because the reported information could become available to different market participants at different times due to transmission delays etc. An advantage of the public reporting model described above is that all market participants should have access to corporate action reporting at the same time. As a reconciliation tool, we also recommend that a transferring broker identify the date of the last corporate action booked relating to each security transferred to assist the receiving broker in determining whether it has or must make a pending corporate action adjustment to securities received.

Broker Practices and Procedures

Ideally, over time market participants will converge on common systems and protocols for capturing corporate action reporting on a real time basis, which will largely eliminate timing as a source of omissions or duplication with respect to corporate actions affecting cost basis of transferred securities. Any attempt to impose a timing requirement for this broker activity could actually impede that development.

31. To what extent a broker should verify the reasonableness of basis information and what document retention requirements should apply;

RECOMMENDATION:
We believe a broker must establish procedures that are reasonably calculated to report basis information correctly. Documents should generally be retained based on current law requirements. Given the potentially significant storage costs, we recommend that the IRS establish a reasonable period of time for record retention rather than indefinite retention such as five years.

DISCUSSION:
Under current law, a taxpayer or any person required to file a return of information must maintain information "so long as the contents thereof may become material in the administration of any internal revenue law." Treas. Reg. 1.6001-1(e). Presumably, a broker should maintain any cost basis information that is associated with proceeds information for as long as the proceeds information could be material to determine the income tax liability of a customer. However, the cost of data storage is a very real and growing concern for many businesses. Given the potentially significant storage costs, we recommend that the IRS establish a reasonable period of time for record retention rather than indefinite retention. We note that the WHFIT rules generally impose a five year record retention requirement following the close of the calendar year to the which the data pertains. See Treas. Reg. 1.671-5(c)(6). We believe that this time period may have been established due to the same storage cost concerns.

32. What procedures a broker should follow if the broker derives basis and holding period information for or from customers with respect to a security that is not a covered security, including potential reporting of such information to either the customer or the Service;

RECOMMENDATION:
We believe a broker may collect information on non-covered securities for or from a customer, and that such information may be shared with the customer (with a proper disclaimer) but need not be shared with the IRS. We note that many brokers and financial advisors currently provide gift and death-related basis adjustments to some of their customers as a customer service. We believe that the inclusion of such adjustments promotes consistency between broker reporting and taxpayer reporting. Accordingly, we further recommend that brokers and other applicable persons within the meaning of Sec. 6045A should be permitted to make gift and death-related basis adjustments (although such adjustments would not be required). We believe that such reporting could eliminate potential audit inquiries that could otherwise arise if the taxpayers report a higher basis due to step-up on death, for example, in connection with the sale of inherited stock. We also recommend that the IRS provide for a single account-type election (comparable to that set forth in Sec. 1012(c)(2)(B)) to include pre-effective date securities to all brokers for any security at a broker's election.

DISCUSSION:
The new legislation requires brokers to report basis information only for covered securities. In some instances, brokers may possess or may obtain information on basis with respect to non-covered securities (e.g., securities acquired prior to the effective date of the new legislation). Brokers are not required to report this information to their customers or to the IRS. However, the cost basis reporting legislation permits mutual funds to elect to report average basis for some stock acquired prior to the effective date. Sec. 1012 (c)(2)(B). We believe this election is helpful, and would extend the election to all brokers for any security.

We believe that the effective dates for covered securities were established due to concerns that many brokers would need time to update their customer systems to comply with the cost basis reporting law. We understand that it was uncertain whether a broker's historical cost basis information for its customers would necessarily be accurate enough in light of the potential information return accuracy related penalty risks. On the other hand, the goals of the broker cost basis reporting—simplification for individual tax return filers and reducing the tax gap, appear equally served with respect to the reporting in future years of sales of previously acquired securities that do not constitute covered securities. In addition, we note that customers may find it confusing or request additional cost basis information from brokers once they begin receiving information returns for covered securities that include cost basis information.

As a result, we believe that it is appropriate and helpful as a policy matter to permit brokers to voluntarily disclose historical cost basis information to their customers. They already do so for some customers. We note that the cost basis reporting legislation does not require that brokers that voluntarily provide such historical information to their customers also provide it to the IRS.

Depending on a broker's level of comfort regarding the historical basis information, we believe that the broker should generally have the discretion to make a single account type election. Such an election could simplify the broker's tracking of cost basis information in its basis reporting system. It would consolidate the method of presentation of the information to its customers. It would also provide the information to the IRS for taxpayer compliance purposes. Thus, providing a comparable single account-type election to include pre-effective date securities to all brokers for any security at a broker's election could benefit brokers, taxpayers and the IRS.

33. What procedures a transferee broker should follow if the broker does not receive a transfer reporting statement;

RECOMMENDATION:
If a broker does not receive a transfer reporting statement, the broker should use reasonable efforts to communicate with the transferor to request the transfer reporting statement. Brokers must establish the existence of procedures that are reasonable calculated to obtain the transfer reporting statement. We recommend that brokers also be

provided two options for such non-covered transferred securities—provide information to customers only or elect to include some or all of any specific non-covered securities in information returns provided to customers and the IRS. Given the absence of the transfer reporting statement, we believe that a reporting broker that makes such an election should be held to a lower, good faith standard of care regarding the related cost basis information for the transferred securities for penalty purposes.

DISCUSSION:
A broker should establish procedures that are reasonably calculated to obtain the transfer reporting statement. Part of these procedures should include reasonable efforts to investigate a failure to receive a transfer reporting.

Note that under the cost basis reporting law, securities for which a broker that does not receive a transfer reporting statement would not constitute covered securities subject to reporting in the hands of the receiving broker. Because the receiving broker would not be obligated to provide cost basis information for such securities, the same concerns regarding coverage gaps discussed in our comments in response to Notice Issue No. 32 could arise. We recommend that brokers be provided the same two options for such non-covered transferred securities—provide information to customers only or elect to include some or all of any specific non-covered securities in information returns provided to customers and the IRS. Given the absence of the transfer reporting statement, we believe that a reporting broker that makes such an election should be held to a lower, good faith standard of care regarding the related cost basis information for the transferred securities for penalty purposes.

34. What procedures a transferee broker should follow if the broker receives transfer reporting information with respect to a security that is not a covered security, or from a transferor who is not subject to the transfer reporting requirements;

RECOMMENDATION:
A broker may choose to ignore transfer reporting information with respect to a security that is not a covered security. Likewise, a broker may choose to ignore transfer reporting information from a transferor who is not subject to the transfer reporting requirements. We recommend that brokers also be provided two options for such non-covered transferred securities—provide information to customers only or elect to include some or all of any specific non-covered securities in information returns provided to customers and the IRS. Given that such transferred securities are not specifically subject to cost basis reporting, we believe that a reporting broker that makes such an election should be held to a lower, good faith standard of care regarding the related cost basis information for the transferred securities for penalty purposes.

DISCUSSION:
Brokers are required to maintain reporting information only for covered securities, and only from certain transferors. Brokers should not be expected to accept information that

is not required, or from a transferor who is not required to provide it. Requiring brokers to accept information will unduly complicate brokers reporting efforts.

Such transfers raise the same concerns regarding coverage gaps discussed in our comments in response to Notice Issue No. 32. We recommend that brokers be provided the same two options for such non-covered transferred securities—provide information to customers only or elect to include some or all of any specific non-covered securities in information returns provided to customers and the IRS. Given that such transfers are not specifically subject to cost basis reporting, we believe that a reporting broker that makes such an election should be held to a lower, good faith standard of care regarding the related cost basis information for the transferred securities for penalty purposes.

35. What procedures a broker should follow with respect to basis adjustments if an issuer report on a corporate action is insufficient or untimely;

RECOMMENDATION:
We recommend that a broker be required to use reasonable efforts to obtain an issuer report on corporation actions, if it appears that the issuer fails to do so in a timely fashion. We recommend penalty relief in the absence of the receipt of needed corporate action reports from issuers and a reasonable efforts standard of care for accuracy related information return penalties relating to such corporate actions. In determining whether a broker has taken reasonable efforts to properly compute basis adjustments relating to corporate actions in the absence of issuer reporting that reaches a conclusion regarding the tax treatment as recommended in our comments under Notice Issue No. 28, we believe that the broker should evaluate generally available information regarding the corporate action, including publicly reported facts concerning the issuer, the information reported by corporate action reporting services and other third parties, or tax opinions or commentaries provided regarding the proper tax treatment.

DISCUSSION:
A broker should use reasonable efforts to obtain an issuer report on corporate action, if the broker knows such a report should have been issued. Unlike the transferring reporting statement rules, the broker cost basis reporting rules do not relieve a broker of its reporting obligation if it does not receive a corporate action report. It is possible that such reports may not be provided timely for a variety of reasons. A broker should not be required on its own to exhaust all possible remedies in obtaining a corporate action report. That would seem unreasonable. Other brokers holding the same securities would be similarly situated. A public reporting system might be in a better position to attempt to obtain a missing report. After some reasonably short period of time (for example, 30 days after the date of the corporate action), a broker should be permitted to use reasonable efforts to process the corporate action in the absence of the missing corporate action report. This approach is necessary because brokers need to update their customers' positions daily and every day after the date of a corporate action occurs increases the likely cost of retroactively adjusting for the missing corporate action. After some relatively short additional period of time (for example, 90 days), a broker should

not be obligated to revise its own booking of the corporate action if the issuer subsequently issues a corporate action report. This approach would also appear appropriate due to the increased cost of retroactive adjustment. We also recommend that the IRS consider whether a determination could be made by a public reporting system. This could provide potential uniform treatment of a missing corporate action by different brokers.

36. Under what circumstances penalties may apply to brokers or other reporting entities and when relief from penalties should be available.

RECOMMENDATION:
Apply present law penalties for brokers who fail to provide the required information reports. That is, brokers should not be subject to penalties if their failure is due to reasonable cause and not to willful neglect.

DISCUSSION:
The current-law penalties for information returns will also apply to brokers and other reporting entities. These rules generally provide for a penalty of $50 for each return for which a failure occurs, subject to a cap of $250,000. Sec. 6721(a). The penalties are increased for intentional disregard of the rules. Sec. 6721(e). The penalties are waived if a failure is due to reasonable cause and not to willful neglect. Sec. 6723. We believe these rules are appropriate for basis reporting.