Notice 2009-17

THE STA
SECURITIES TRANSFER ASSOCIATION, INC.

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS BRANCH

MAR 20 2009

Revised Copy

March 18, 2009

Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-17)
Room 5203
P O Box 7604 Ben Franklin Station
Washington DC 20044
Attn: Stephen Schaeffer

Re: IRS Notice 2009-17
Issues with Average Cost

Dear Mr. Schaeffer:

As indicated in our previous response to the IRS request for comments on Notice 2009-17, the STA would like to elaborate on the issues we have discovered when examining the use of average cost for Dividend Reinvestment Plans, (DRPs). Although it initially seemed that average cost might be a useful method of calculation of basis for DRP's, upon closer examination by our members, we find it unworkable for equities. The reasons follow.

The operation and administration of DRPs are governed by the provisions of the Plan Prospectus. Under the terms of most of these Plans, a shareholder may choose to deposit certificated shares into the Plan or have a certificate issued for some or all of his shares while maintaining active participation in the Plan. This provision appears to make shareholders ineligible to use average cost basis for the Plan shares. IRS Publication 564 precludes the use of average cost for certificated shares, stating "You can figure your gain or loss using an average basis only if you acquired the shares at various times and prices, and you left the shares on deposit in an account handled by a custodian or agent who acquires or redeems those shares." In addition, Treasury Regulation 1.1012-1(e) states that average cost may be used only when "shares of stock of a regulated investment company… are left by a taxpayer in the custody of a custodian or agent in an account maintained for the acquisition or redemption of shares of such company….." Although this regulation was written to pertain to mutual fund shares, it appears to preclude the use of average cost when shares are issued in certificate form.

P.O. BOX 5220 • HAZLET, NEW JERSEY 07730 • (732) 888-6040 • FAX (732) 888-2121 • EMAIL: cgaffney@stai.org • WEB: http:\\www.stai.org

Certificate issuance, as allowed by terms of most DRP prospectuses, conflicts with the regulation that sets the rules around the use of average cost. In the equity world:

- Prohibiting a shareholder from receiving a certificate is not allowed under the terms of DRPs unless the issuer prohibits certificates and either (1) allows Plan sales or (2) participates in the Direct Registration System ("DRS").
- Many shareholders prefer to set parameters around the sale such as a stop or a limit order, an option not available in DRPs. Thus, the only alternative available to control the sale for investors in companies not participating in DRS is to deliver a certificate to the broker.

Another difficulty arises in the equity environment stemming from the various ways that shares may be held. Unlike mutual funds, which have only one type of book-entry shares, book shares of equity securities in the same shareholder account at the transfer agent, may either be Plan shares (held in accordance with the Plans discussed above) or Direct Registration System (DRS) shares, not in a Plan or subject to the Plan Prospectus. These two categories of book-entry shares must be tracked separately by the agent to comply with existing securities laws. This adds significant operational complexity to using the average cost method to calculate basis.

The present regulation allows a Plan Administrator to determine if FIFO or average cost will be the default method of basis calculation for DRP's. As indicated in our previous correspondence, the STA foresees irresolvable issues when shares move between one covered institution that might offer average cost and one that does not. Unlike mutual fund shares, equity shares frequently move between brokers and agents, between brokers and brokers, and between prior and successor agents. Since shareholders electing average cost cannot change to another basis calculation method, basis could be reported incorrectly on Form 1099-B upon sale, should their shares move to a covered institution that does not offer average cost.

Our final concern is that the present regulation, allowing either average cost or FIFO to be the default method for DRP's would require transfer agents to program for at least two sets of programming to calculate basis for these plans—in addition to the specific identification method. This greatly increases the cost of programming, testing, and operating these systems, adds increased complexity to the training of customer service staff, and, most importantly, increases the likelihood of confusion for the shareholder. Considering all the aforementioned reasons why STA members find average cost unworkable for equities, we urge the Treasury Department and the IRS, as the guidance for the implementation of this regulation is promulgated, to allow equity agents the alternative to exclude it as a basis calculation method.

Sincerely,

Charles V. Rossi
President
The Securities Transfer Association, Inc.