

Notice 2009-17

DATE: 03/26/09

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

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

APR 20 2009

RE: IRS Notice 2009-17

Dear Mr. Schaeffer:

Wells Fargo & Company (Wells Fargo) is one of America's largest financial institutions offering services and products in retail banking, corporate trust, shareowner transfer agent, retail brokerage, institutional brokerage and mutual funds to customers in 39 states (50 states for retail brokerage locations). As such, we appreciate having the opportunity to provide our comments and insight regarding cost basis reporting.

In addition to our specific responses below to IRS Notice 2009-17, we believe it is critical that the IRS consider the following preliminary themes:

1. Cost implications in the current market environment: It is important to realize that even though many (but probably not most) retail brokerage firms provide this information currently to individual customers for courtesy purposes only, virtually none of the other business units having customer accounts within a financial organization do so. They have no programming, staffing or experience with cost basis reporting. Since business units within a single financial institution all use different programs to maintain accounts, the additional programming, staffing and other related costs will be extremely high when funds for such projects are not readily available at this time.
2. Timing is of the essence for issuance of guidance: Most cost basis information currently being provided is based on general rules, is not well maintained and is not standardized. The IRS needs to issue clear and concise rules quickly if current effective dates are retained. Firms such as ours with vast and interconnected systems simply cannot begin the costly process of enhancing all of the interdependent technologies needed to comply with the new rule in a timely manner without clear and definitive guidance from the IRS.
3. Penalty relief: Throughout the following comments, it is apparent that the information financial services firms will report almost certainly will create many new disputes among financial institutions, their customers and the Internal Revenue Service. In particular, financial institutions cannot control how taxpayers report cost basis on their tax returns when so many outside factors can impact what the institutions may have provided.
4. Taxpayer confusion: (a) One of the concerns creating considerable discussion within the industry is whether or not to include cost basis information for securities that are not "covered." The IRS needs to announce clear standards as to whether firms must provide, if available, only that information in a supplementary information section separate from all other Form 1099 information (the proposal we favor). The general consensus is that customers will not want the alternative where firms provide information to the IRS with the Form 1099-B information for securities that are not "covered." Customers will probably subject the firm to numerous complaints and lawsuits if the IRS adopts this proposal. (b) Firms that already provide cost basis

information are experiencing frequent taxpayer complaints because foreign issuers have no requirement to provide cost basis or tax reporting information related to U.S. taxpayers as a result of corporate actions. On another issue, customers also complain whenever we are unable to provide cost basis information on the effective date of a merger or other corporate action, even though the fair market value (FMV) of shares received may not be available for several days thereafter based on trading activity. For that reason, the date of January 15 following the applicable tax year in the current legislation to provide this information to reporting entities will not be a workable solution.

We are encouraged, therefore, that the questions posed by IRS Notice 2009-17 reflect an understanding among IRS staff that the complexity of cost basis reporting and the need to standardize the information will require detailed analysis and substantial work between now and the effective dates in the Emergency Economic Stabilization Act of 2008 (Public Law 110-343, Section 403).

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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. The current Treasury regulations include various definitions of a “middleman.”¹ It is our opinion that the definition found in Treasury regulation 1.6049-4(f)(4) includes most, but not all, of the entities which should be subject to the transfer and reporting requirements. Currently, few business units within Wells Fargo other than Retail Brokerage and Shareowner Services have any programming available to provide cost basis information, and since it was done for courtesy purposes only, those systems will require significant and costly modifications in order to comply with the legislation. All other business units would have to purchase or create programming and hire additional staff to support these reporting requirements.

Generally, however, for cost basis reporting to be effective and fair, it is important that any entity which disburses money or other property resulting from a sale or exchange be required to provide cost basis information along with the Form 1099-B. As stated in more detail below, however, because taxpayers can move accounts from one middleman to another, or assets between accounts, there will be instances when the security will be sold in one account, but distributions made prior to that transfer and subject to reclassification to return of capital (as an example) which impact that cost basis will be reported on the Form 1099-DIV for the previous account issued by a different middleman.

In addition, any entity that holds any securities on its books (either directly or through an agent) should be subject to the transfer requirements. While we are cognizant of the jurisdictional difficulties, many of us within the American financial industry are particularly concerned that foreign entities will not be subject to these requirements. The result of their not being required to provide or transfer cost basis information will be a significant gap in the reporting process. In addition, it will create the possibility of a U.S. taxpayer transferring an account to a foreign broker or financial institution, then transferring the account back to another U.S. broker or entity, resulting in no cost basis information being received. For customer accounts where we are already providing

¹ For example, see Treasury regulations §§1.671-5(b)(10), 1.6049-4(f)(4), 1.6049-5(c)(5) and 31.3406(a)-4(c).

some cost basis information for courtesy purposes only, the fact that cost basis information is often unavailable for foreign securities, rights or warrants is a source of frequent complaints.

Given the fact that cost basis information is often not available for foreign securities or U.S. grantor trusts and funds that hold foreign securities in their investment portfolio, plus a foreign “middleman” will not be subject to the reporting and transfer requirements, penalty relief will be needed when a U.S. entity cannot provide this information.

- 2. Who, in addition to brokers, should be treated as “applicable persons” subject to the transfer reporting requirements?** See the response to Question #1 above. At the outset, we urge the IRS to maintain exemptions from cost basis reporting similar to those exemptions that currently exist for Form 1099-B reporting (See Treasury Regulation §1.6045-1(c)(3)). A significant number of institutional customers are not subject to this reporting, so it will be critical that firms are not burdened with preparing to report or transfer cost basis for these clients. It is important to reiterate that many financial institutions and entities do not currently have systems in place to transmit or receive account information similar to what currently exists through the Depository Trust & Clearing Corporation (“DTCC”) and its Cost Basis Reporting Service (“CBRS”). The financial industry and its various trade associations are all in agreement that all customer account cost basis information must be transferred electronically rather than by paper notification which will frequently get lost and not processed. In addition, mechanisms such as a page on the IRS site on the internet needs to be established as a central repository for information related to corporate actions and liquidations of securities pursuant to bankruptcy court proceedings. It is important that a mechanism be developed for an audit trail, since the reporting entity will frequently not have any historical information if the account or security was transferred to that entity immediately prior to its sale or exchange.

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

This is an important consideration for securities that consist of more than one component, or trade like one type of security but are recognized under tax principals as another type. The determination as to the type of security must be made by the issuer. In addition, there are frequently instances where the cost basis system has to be “tricked” in order for their distributions to be processed correctly by other programs that are used to pay their distributions. As a result of all the “downstream” processing impacts, plus the fact that there is no standardized mechanism for coding securities, the result will be a particular security being considered as a “covered security” by one middleman with different recognition by another middleman. A few examples of where this will occur include the following:

- a. Hybrid securities coded as either equities or debt obligations: These investment unit securities that trade like equities can include both a debt obligation and a forward or put contract component. Therefore, cost basis systems may have these coded as either equities or debt. The debt obligation may be subject to original issue discount accruals, which in turn creates a cost basis adjustment for that part of the security. Generally, the value of the forward contract at issue is \$0, but fluctuates up or down according to market conditions. A put contract component will generally start with a \$0 stated value and then move to a negative cost basis amount based of the un-reportable put premium received. Virtually no cost basis systems have each investment unit broken down into its separate components in order to reflect the accurate basis for each component. Some issuers remarket the debt obligation component before the contract is due, and replace one type of debt component

with another type (such a Treasury STRIP), adding to the complexity of cost basis tracking within in a single tax lot. That remarketing results in Form 1099-B reporting before the maturity or exchange date when the tax lot is closed by either receiving cash or shares, and that contingent payment debt instrument subject to the Form 1099-B reporting is not eligible for capital gain or loss treatment in most cases. Finally, these securities often require additional cost basis adjustments and taxpayer recognition on their tax return when periodic and/or final cash payments are above or below the projected payment amounts.

- b. Debt obligations coded as equities: Securities that are described as bonds may make distributions that are treated like dividends. For example, a security issued in June 2008 called “Allianz SE Undated Subordinated Callable Bonds” (CUSIP 018805200; Symbol AZM) created much confusion for Tax Year 2008 because most brokers had it coded in their security master files as a debt obligation based on the name, but then had to change the reporting of the distributions to dividend income based on the announcement found in the prospectus, as follows: *Subject to the limitations described below in “Taxation — United States Taxation,” the interest received by certain individuals subject to U.S. federal income taxation is expected to be treated for U.S. federal income tax purposes as dividends subject to tax at a maximum tax rate of 15% if the dividends are “qualified dividend income” and are received before January 1, 2011. A legislative proposal introduced in the U.S. Congress in 2007 generally would, if enacted, deny qualified dividend income treatment to interest payments on the Undated Subordinated Bonds received after the date of enactment. It is not possible to predict whether or in what form this proposal may be enacted into law.*
- c. Equities coded as debt obligations: Equities (such as depositary shares representing preferred stock) are coded as debt obligations because their payments are based on a set coupon rate or a fluctuating rate such as LIBOR even though the distribution is considered a “dividend” because of the type of underlying security represented by the depositary share.
- d. Funds established as grantor trusts coded as both domestic and foreign: If a U.S. security that is established as a grantor trust holds various types of domestic and foreign securities within its portfolio, the cost basis system often has to be changed temporarily from a domestic to a foreign security in order for distributions from a foreign security that include foreign withholding at source payments to be processed correctly.

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.

Treasury Regulation section 1.1012-1(c) states that the default method is First-In First-Out (FIFO) unless the taxpayer “at the time of sale or transfer . . . specifies to such broker or other agent having custody of the stock the particular stock to be sold or transferred.” Therefore, the default method used is FIFO by entities that currently transact sales for customers, and they have processes in place to provide confirmation statements or other communications if something other than FIFO is utilized upon request from customers. Since it has always been – and should always be – the taxpayer’s ultimate responsibility to report cost basis information correctly, this process has worked fairly well to date. Now that a middleman will be required to report cost basis information, this raises concerns about what constitutes “adequately informing” a customer of the default method other than the Form 1099-B being revised to include an indicator. If a notification is provided earlier, we anticipate taxpayers stating they never received that letter or other type of communication. What happens if the middleman uses FIFO as the default method and the taxpayer delivers certificates for sale from

that account, but the programs indicate the FIFO method is the default method even when those certificates were sold as requested and may have been purchased after the oldest tax lot for the same security in the same account? Also, care must be taken in the definition of the word "account," which has different meanings to different types of businesses. For example, in the mutual fund environment, an individual taxpayer can have multiple accounts based on the shares owned in different funds, since the distributions must be reported separately. Conversely, that same customer with a single brokerage account could have shares from multiple mutual funds within that single account. Therefore, it would be possible in the mutual fund environment to have FIFO, specific identification and/or average cost basis in the multiple accounts for that single taxpayer. In the brokerage environment, the taxpayer would have to set up separate accounts for each type of cost basis determination method elected.

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?

We anticipate customers will make multiple elections throughout the year in order to explore which cost basis calculation is most beneficial to them. The programming and system requirements to track and retain historical information in order to recalculate cost basis each time the taxpayer makes a different election would prove enormously expensive. Outside of the mutual fund industry, most systems do not provide average cost basis information. Finally, as noted previously, the fact that a single account can hold both plan and certificated shares could necessitate bifurcation of accounts that would lead to greater customer confusion.

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.

See responses to Questions #4 and #5 above. Many business units will not offer average cost basis to customers because the programming requirements are extremely expensive.

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

As previously noted, the definition of an "account" varies by the type of business involved, as well as how shares (e.g., street name, certificated, restricted, etc.) can be held in an account. It will be confusing to customers that they can elect one cost basis method at one institution and business unit and not at another. Therefore, each middleman should be allowed to determine which type of cost basis determination(s) will be permitted.

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").

No comment.

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

Many business units have never offered average cost basis reporting information to customers because the programming requirements are complex and expensive, and do not intend to do so in the future. In addition, there will be situations where, within a single account, the original shares are

“covered” and eligible for one type of cost basis election but the reinvested shares are eligible for average cost basis.

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

Many business units have never offered average cost basis information reporting to customers because the programming requirements are complex and expensive, and do not plan to do so in the future. In addition, the current rules do not state what happens when a shareholder balance goes to zero and more shares are subsequently purchased. Can the investor change the election or does the previous election govern? What happens if the taxpayer elected average cost basis at one firm or company, and then elects a different cost basis method at the receiving firm after the average cost basis information has been transferred? What happens if the plan administrator of an employee plan elects FIFO, but the participant wants to report based on average cost basis or specific identification? What happens if a DRIP has suspended payments but allows the investor to make cash investments?

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.

This decision will largely be driven by the type of business unit and account. Many business units will elect not provide average cost basis reporting information. While there is no consensus, many firms have stated they either will not provide cost basis information for securities that are not covered, or do so only in a supplementary statement that is not part of the Form 1099-B reporting process.

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.

The few entities that already provide some basic cost basis information are aware the information is either not accurate or reflect what the taxpayer may eventually report on their Schedule D. Therefore, they will either not provide that information or do so only on a supplementary statement. For shares purchased after 2011, the Schedule D will require significant modifications so that the taxpayer can have the opportunity – similar to what is currently allowed for Schedule B – to include a reconciliation amount between what is reported on the Form 1099-B and Schedule D. For example:

Form 1099-B reported basis:	\$1,000.00
Adjustment: Transfer fees	<u>50.00</u>
Basis for gain/loss calculation:	\$1,050.00
Form 1099-B gross proceeds	<u>(\$ 750.00)</u>
Loss on sale	\$ 300.00

In addition, the Schedule D needs to be modified to allow for other types of adjustments or reporting reconciliation. For example, the gain or loss realized for contingent payment debt instruments generally cannot be treated as a long-term capital gain or loss, but must be recognized as ordinary income. There is currently no place on Schedule D for the taxpayer to reconcile this reporting on the Form 1099-B to what they should report on Schedule B or their Form 1040.

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

Each security for which gross proceeds and cost basis reporting is required on Form 1099-B would have to include an indicator identifying which election was used (e.g., FIFO = F, LIFO = L, specific identification = S, average cost basis = A). For transfers, a similar indicator would be needed if the receiving entity was going to be responsible for this reporting for any reason. The IRS will have to provide guidance on whether or not the receiving middleman can apply a different cost basis election, and if so, what additional information the sending middleman would need to provide. This would greatly increase the programming complexity and costs of the information to be transferred, and require firms to keep historical purchase and adjustment information even when the taxpayer elects the average cost basis methodology. Also, the IRS needs to provide guidance about how elections must be communicated and specific deadlines for doing so.

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

See the response to Question #12 above. In addition, since the taxpayer can make elections about secondary market purchase conditions (e.g., market discount or acquisition premium) that in turn impact cost basis adjustments of which the middleman may not be aware, the Schedule must be reformatted to provide the taxpayer with the opportunity to include this information.

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.

It seems this would violate the current regulatory requirement in Treasury regulation 1.1012-1(c)(3)(a) that such identification is made “[a]t the time of sale or transfer.” This rule should be maintained.

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.

Many business units, such as transfer agents, should be exempt from this reporting requirement. In addition, there are instances where the transaction could technically trigger the wash sale rule but should be exempted from this reporting process, including but not limited to the following situations:

- The sale of fractional shares required to facility the transfer of whole shares from one account to another, or resulting from a corporate action.
- The repurchase of shares as part of a dividend reinvestment plan 30 days before or after the date an investor requests the sale of identical shares
- Automatic purchases of shares that are part of a mutual fund share conversion.
- The purchase of shares for accounts that have overnight sweep options where cash is converted to shares in a money market or other fund.

The following items also increase the complexity and costs of this reporting requirement:

- This rule can also be triggered by the purchase of options contracts for the identical stock, and most entities have either no programming to “marry” these transactions, or what does exist does not work well.
- A determination must be made as to what happens if a security is sold that is not covered and shares are purchased after the effective date for that particular type of security.

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

Current systems will need to be revised to include the reporting for these, and we already are aware of multiple issues where systems have difficulty “marrying” the option contract when the customer has multiple exercises and assignments processed on the same day involving the same underlying stock. Further clarification of the EESA requirements is necessary, particularly for which securities this will be required and when. It is assumed, but should be clearly stated, that this does not apply to Section 1256 contracts. Determining the holding period as short-term versus long-term can be challenging, since it often depends on how the option position is closed.

Basis reporting on options is further complicated when a security is comprised of multiple tax attributes, such as occur in the REMIC industry. Trusts that elect REMIC status for selected assets often include non-REMIC attributes as well. Only payment on the REMIC regular interest from the REMIC will be treated a debt payments. Specified payments to bondholders, such as contingent strips of cash excluded which were from the REMIC, will not be treated as a part of a debt security. Payments, known as basis risk shortfalls, also occur between REMIC regular interests and are treated as non-REMIC payments. Payments on particular CUSIP applicable to a security issued from a trust can represent a multitude of different tax investments, including a REMIC regular interest, a deemed interest rate swap, a partnership interest or a grantor trust interest. Technically each piece will require a separate basis, tracked uniquely. Each purchaser will be required to allocate basis to each tax component of the investment. Brokers will not have the details of the tax attributes of the security. Commonly these non-REMIC payments have a separate tax reporting regiment. It is important that the tax basis reporting rules eliminate any requirement to report basis for securities already reporting under the WHFIT guidelines or other entity level reporting obligations such as when shares are treated for tax purposes as a partnership interest.

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.

Yes, because there is currently no deadline as to how long a short sale can remain open, and this will create cost basis reporting problems if the position is transferred to another broker. In addition, various factors as outlined in IRS Revenue Rulings 2002-44 and 66-97 impact when the taxpayer cannot defer the loss, which will be difficult and costly to implement from a programming standpoint.

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 account for securities.

The items below provide some examples of issues that already exist for those business units which already provide some basic cost basis information, and the IRS needs to provide guidance or issue regulations which clarify the reporting requirements for these securities and these types of situations:

- a. Hybrid securities and structured products can consist of more than one component, each of which has separate and different cost basis, such as “investment units” which must allocate basis pursuant to Treasury Regulation §1.1012-1(d). Similarly, units of a royalty or other type of grant trust can represent multiple components that have separate cost basis allocations. Most cost basis systems do not have the capability of separating the multiple components that comprise a single share or unit that constitutes a tax lot.

- b. For taxable debt obligations, secondary market adjustments (e.g., market discount and acquisition premium) are taxpayer elections. Most firms do not provide this information currently and those that do provide it as supplementary information. The calculation of this information is complex, plus it does not apply to all securities. Knowing whether or not the taxpayer has made such elections is impossible to determine with any degree of certainty. The identification of securities such as contingent payment debt instruments where the elections are not available is generally not well documented or maintained on security master systems.
- c. For tax-exempt municipal bonds, most broker dealers may not adjust basis because the original issue discount is not subject to Form 1099 reporting and including it as supplementary information is expensive to purchase, calculate or retain.
- d. For gift and death-related securities, what cost basis information the broker should accept, as well as what records should be retained, creates additional concerns as to the degree of due diligence that is required to question the information provided by the taxpayer. Transfer agents are already concerned about the rules around gifting and death related adjustments. While they are working with our industry partners (brokers, DTCC, other transfer agents) to exchange tax cost basis information, a registered shareowner is under no obligation to reveal the reason for the transfer to the transfer agent. They have no knowledge as to whether the shares are being distributed as a gift, inheritance, as private sale or have been bartered in exchange for some other service. If the shares were originally covered shares, the issue is complicated by the fact that the original tax cost basis would have nothing to do with the adjusted cost basis related to a gift or death. The agent can not assume what cost basis to apply and the transferring party is under no obligation to provide that information to the transfer agent.
- e. In regards to the mortgage securitization industry, a comprehensive process for getting information to the investors was established by the IRS in accordance with IRC §1.6049-7. To this end, there should not be any obligation for brokers to provide a tax basis to investors for REMIC Regular Interests, CDOs or any other mortgage backed securities (i.e. GNMA securities) that rely upon the IRC §1.6049-7 reporting mechanism. REMIC tax preparers prepare supplemental tax information that assist investors in determining the taxable income and tax basis of their investment. Publication 938 advises investors where to obtain this information. Websites have been dedicated to posting this information. Brokers and third parties use this information to prepare 1099-INTs and 1099-OIDs and also provide the supplemental information directly to the investors, typically including an explanation as to how to calculate market discount, market premium or acquisition premium. No tax basis reporting for REMIC regular interest should be required of the broker since the investor has the option of many different approaches to amortizing and recognizing income, including one that completely recasts any OID on the instrument by treating the instrument as if upon purchase it was newly issued. (i.e. §1.1272-3: Election by a holder to treat interest on a debt instrument as OID using the constant yield method as of the date of purchase). In addition, there are approaches taken on loss recognition that impact the tax basis calculation. Adjusted basis calculations for structured securities, such as a collateralized debt obligations or REMIC securities, are very complex and often reserved for tax experts. At a minimum, the IRS should consider extending the tax basis reporting for investments in structured securities that require information reported under IRC §1.6049-7 given that the deadline for providing supplemental tax information under that regulation is the latter of January 31st or two weeks following the request for supplemental information. The IRS should consider providing a worksheet or automated tool for investors to perform the necessary calculations to derive

their taxable income and tax basis. There are additional items that are not currently required to be reported under §1.6049-7 that could benefit investors and may be appropriate to add to the supplemental reporting, such as principal payments and losses. We welcome the opportunity to discuss this option as an alternative to tax basis reporting for REMIC regular interests and CDOs.

- f. Regarding the overall deadline for the new tax basis reporting, it is appropriate to extend the basis reporting deadline to much later than February 15th. Calculation of a tax basis will remain an obligation of the investor and therefore will be separately calculated and used by the investor (i.e. this new tax basis reporting is not intended to be a substitute, but rather a guide, for the investor's tax basis calculation). This new tax basis reporting will serve primarily as a complimentary tool for the IRS to evaluate the reasonableness of the investors' calculations. In fact, IRS will not be able to validate this information with certainty until the taxpayers prepare their tax returns and perhaps not until an audit is performed much later than the filing date.
- g. The reallocation of distributions as return of capital by RICs and REITs can occur any time after December 31 of the applicable tax year for as long as four tax years thereafter. This long timeframe creates processing and reporting issues for brokers and taxpayers who could have sold those shares in the interim, or left the firm and transferred those shares to another firm.
- h. Cost basis is also impacted by a RIC or REIT deciding not to distribute capital gains, and that information is generally not provided until February or March of the year following the applicable tax year for which cost basis would be impacted.
- i. In addition to these items, valuating liquidations, recapitalizations and reorganizations is particularly difficult since neither the entity nor the bankruptcy court involved provide sufficient information. Liquidating trusts can provide for payments over several decades, creating concerns about when to close the tax lots involved.
- j. Foreign corporations provide little or no cost basis information, particularly for shares, rights or warrants that cannot be held by U.S. investors. This lack of information impacts depository banks or transfer agents creating or providing information related to American Depositary Receipts (ADR) or Shares (ADS) that represent those foreign securities but are subject to corporate actions that have cost basis and information reporting impacts. Those foreign entities have no legal obligation to provide cost basis information and are generally outside the jurisdiction of U.S. regulatory authorities.
- k. Form 1099-B reporting rules can differ from realized gain/loss reporting rules. For example, for a "gain/no loss merger," the Form 1099-B generally reports only the cash (including the FMV of other property, if applicable) received as "boot." The taxpayer, however, reports as gain the lesser amount of the boot received, or the gain realized.
- l. Companies going through a fully taxable merger often announce values of shares received based on the closing price on the effective date of the merger, and do not take into consideration the rules found in Treasury Regulation §25.2512-1 through §25.2512-4.
- m. The calculation of cost basis for fractional shares related to cash-in-lieu reporting is not uniform. Some firms may apply the factor to determine the shares to be received by each tax lot. Other firms might aggregate all tax lots before applying the factor. Also, firms apply different calculation methods for determining the cost basis of the fractional share. Some firms apply the \$20 threshold while others do not.
- n. Special long-term loss reporting requirements for mutual fund shares held less than 31 days when certain conditions exist pursuant to 26 CFR 1.852-4(d).

- o. For mergers and maturities that have an effective date of December 31, there are timing issues that impact which tax year should apply. Generally, the cash and/or shares are not credited to the account until the following tax year so the reporting is done in accordance with the general rule that is reportable in the year when “it is credited or set apart to a person without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and is made available to [the taxpayer] so that it may be drawn at any time, and its receipt brought within [the taxpayer’s] own control and disposition.”²
- p. Need to address the cost basis adjustment issues related to sales load deferral situations for mutual funds.

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.

Apply the “spot rate” rules contained Treasury Regulations §§1.6045-1(d)(6) and 1.988-1(d)(1).

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.

Providing all of the information below could prove expensive and difficult to transfer or receive:

- a. Name of reporting entity, contact person and telephone number.
- b. CUSIP number and symbol (in case there is an error with one or the other)
- c. Quantity of shares or units (currently would be a whole number since ACAT process does not permit transfer of fractional shares)
- d. Original purchase date by tax lot* (Trade and Settlement date)
- e. Original purchase amount*
- f. Unit or share price* (as well as defining the number of decimal places)
- g. Adjusted cost basis amount*
- h. Covered or uncovered indicator
- i. Reason code if uncovered
- j. Cost basis election (FIFO, average, etc.)
- k. Cost basis source
- l. Amortization and accretion elections for secondary market conditions
- m. Date of last basis adjustment
- n. Unique transaction identifier number
- o. An audit trail to determine who had the original cost basis information
- p. Original factor for factorable bonds

² For example, see Treasury Regulation §1.6042-2(b), or 26 CFR 1.852-4 which states “a shareholder receiving dividends from a regulated investment shall include such dividends in gross income for the taxable year in which they are received.” However, these aforementioned general rules are modified by, including but not limited to, the following exceptions: (a) the spillover payment reporting rules applicable to RIC and REIT dividends received in January with a record date in October, November and December of the previous year pursuant to IRC sections 852(b)(7) and 857(b)(9); (b) the “sale date” definition found in Treasury Regulation §1.6045-1(d)(4) which requires reporting of gross proceeds based on the trade date instead of the settlement date ; and (c) the date of receipt by the trust instead of the investor for widely held fixed investment trusts under Treasury Regulation §671-5. These timing differences create additional taxpayer confusion about when income or proceeds amounts are reportable or should be included with a tax return.

*This might prove difficult or impossible for fund companies and firms whose clients who have elected average cost basis for mutual fund shares.

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.

If provided electronically, the 15-day timeframe should work. If provided in a written manner, it could take much longer to generate the information and have it mailed. The latter process would often have to be coordinated with print facilities and could create problems during periods of high volumes, such as with monthly statements. The information that is required to be transmitted must be coordinated with the SEC transfer turn-around requirements, or the SEC rules will need to be adjusted accordingly. In addition, these following situations will immediately result in the transferred information being incorrect:

- a. The cost basis information is transferred, but the issuer of common stock or RIC/REIT shares announces any time thereafter (up to four years) that the dividend distribution is being reallocated to return of capital.
- b. The taxpayer transfers an account on or immediately after the effective date of a corporate action when much of the information is still not available.

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

When a shareowner elects to ask the transfer agent to facilitate the transfer of their registered shares they will be given the opportunity to apply specific tax lot identification. However, if the shareowner elects to facilitate a transfer of their registered shares to the books of a broker by enlisting the receiving broker to complete the transaction, the specific lot identification option is not available. The system used (DRS Profile) to complete these request was developed for FIFO only. It would also seem that not requiring the prior election to continue upon transfer would permit some taxpayers to "game the system" and choose a different election when current regulations require permission from the Commission to change. This would be true not only with the average cost basis election for mutual fund and reinvested shares, but also with secondary market elections for debt obligations.

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

The answer to both questions is an emphatic "yes." Wells Fargo supports the need for an electronic solution that has a common format. For this reason, our Shareowner Services division is very actively involved with a joint committee of members representing STA, SIFMA and DTCC to look at the opportunity to enhance the current CBRS system which is support by NSCC. This system is currently used by the brokerage community to pass tax cost basis between firms who have chosen to record tax cost basis. Electronic transfer reporting is necessary to prevent delays or lost information. If it is provided only in a written format, it will often not be received by the appropriate unit or division within a large company.

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

This might be possible, such as using DTCC (which is not available or widely used by most business units that currently hold securities for customers), but the current economic environment and cost restraints will result in little funding for such work at this time. Transferring parties should be

allowed to contract with third parties to meet their regulatory requirements, if they so chose, due to business reasons.

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.

Yes, this would need to be addressed in the requirements listed in Question #21 above. A "Covered" or "Uncovered" indicator and reason code will be necessary to alert the receiving agent. There will be instances where a security is not covered not only because of the transition dates, but because of other circumstances, such as gifted shares. Also, the law needs to be clarified that the transfer of an uncovered security does not make it a covered security.

Issuer Reporting

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

The information below are some examples of the information needed, but seldom received as the result of an organizational action:

- a. Classification of each security being delivered and received as either stock or debt. For example, see IRS Notice 94-47 and Revenue Ruling 85-119 about treatment of debt obligations as equity based on various factors. If bonds or notes are being received for shares, or vice versa, whether or not that is a reportable event since some securities that look like debt obligations can sometimes be treated as equity and considered a "like kind exchange" that would not create a reportable transaction.
- b. Statement of FMV of securities received.
- c. Statement of both effective date and applicable reportable tax year if the corporate action has an effective date between and including December 25 – 31.
- d. Clear statement of reporting requirements for shares, bonds or units being retired, for example, exactly what part is gross proceeds and what part is dividend, as well as what type of dividend is being paid?³ If an allocation of the consideration received is required, the issuer must provide the allocated cost basis information.

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

The primary concern with the EESA timeframes is that the issuer has until the January 15 date to provide information to the reporting entities. The date in the EESA does not require the corporation to provide information to nominees until "January 15 of the year following the calendar year during which such action occurred." That date is too late, and will have a negative impact to customers who wish to sell shares prior to that date if the corporation is not required to provide information within a timeframe closer to the effective date of the corporate action. Therefore, the IRS should require the following:

- a. All information statements should have a standard format and be posted on the IRS web site for access by all financial institutions and taxpayers within 5 business days of the effective date of the organizational action. Having it on an IRS web site would make it readily available for anyone, including the taxpayer.

³ For example, if a "tender offer" does not meet the IRC §302(b) tests, then it may require reporting of all or part of the distribution as a dividend under IRC §301. That "dividend" amount can be ordinary dividends or return of capital which is reportable on a Form 1099-DIV and not on a Form 1099-B. This event also impacts the determination of the cost basis for the shares delivered, as well as the cost basis for any new shares received.

- b. Corporations or entities undergoing an organizational action, or whose hybrid securities are undergoing an organizational action, should be required to announce clearly defined reporting consequences to a U.S. investor.

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.

This is a major obstacle with cost basis reporting and a frequent source of complaints from customers. Currently, and under the EESA, foreign issuers have no legal duty to provide any information related to cost basis or impacts from corporate actions. As a result, there is generally little or no cost basis information available for the securities, rights and warrants that they issue. In addition, may foreign issuers create "B shares" that are sold only on a foreign exchange because they cannot be held by U.S. investors, creating Form 1099-B reporting requirements with no corresponding cost basis information.

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.

This is a particular concern within the financial industry, as it will be particularly difficult if the issuer comes back several weeks or months later and restates its position as to the tax and reporting impacts. In response to Question #21 above, we stated the transferring entity must provide the date of the last cost basis adjustment, which in turn would allow the receiving middleman to determine if the prior middleman or entity had adjusted the cost basis to reflect the most current corporation action event. In addition, the middleman who is required to report cost basis should have penalty relief for any announcements made after March 1 of the year following the taxable year that would have cost basis impacts.

Broker Practices and Procedures

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

The middleman that is required to provide cost basis information should not be subject to information return penalties related to accuracy if the cost basis information received was inaccurate. The receiving entity should be allowed to rely on the information received as being accurate without further investigation or due diligence requirements. Records retention should track SEC requirements, or IRS Publication 1220 requirements (3 years from the due date of that taxable year, or 4 years if federal tax withholding was applied).

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.

If the middleman decides to provide information for a security that is not "covered" as defined in the law, the IRS should state that it can only be provided as supplementary information. It should not be part of the Form 1099-B reporting process. The IRS should announce that the middleman has no requirement to provide cost basis information for a security that is not "covered," and that it is always the taxpayer's responsibility to track and report that information, as well as reconcile the cost basis information provided for a "covered" security if the taxpayer has access to additional information (such as secondary market elections) of which the middleman was unaware.

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

It is imperative that the IRS provide adequate guidance and sufficient time for financial institutions to create programs to transfer information to each other, since that process is not currently utilized except by a relative handful of brokers. The receiving middleman should be allowed to reject any transfer of information that is incomplete, and penalty relief should be provided if the transferring middleman does not provide complete or accurate information to the middleman with the cost basis reporting responsibility. As noted above, the success of this process is directly related to the IRS requiring electronic transfer of information within the timeframes currently mandated in the EESA, but allowing additional time if the information is rejected back to the transferring middleman because it was incomplete.

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.

Depending on their own best practices, the transferee should determine if they will store this information for the shareowner. They should not report this information to the IRS. A transferor should be required to retain and record tax cost basis information on covered securities regardless of whether or not they are a reporting entity. While a security may be held by a non reporter if the securities are ultimately sold they will be sold by a reporting entity. The reporting middleman must be able to rely on the original issuer of the securities for the tax cost basis information.

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

The cost basis information should be left blank with an indicator that the broker could not determine how to report the information because it was not received prior to December 31, or the information provided was not clearly stated to make a determination.

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

It must be taken under consideration that the middleman responsible for generating the Form 1099-B does not completely control its own ability to produce a complete and accurate tax form, since the basis of shares, purchase date and other information must be received, in many cases, from another institution. If the transferee has completed its due diligence in the process, it should be exempt from any information reporting accuracy penalties. The same consideration should be applied to receipt of late cost basis information, receipt of updated cost basis information, and announcements that impact the cost basis but relate back to dates prior to the transfer. The due diligence performed in these situations would be supported by the "date of last adjustment" field referenced in Question #21. In addition, due to the complexity of building the electronic systems to pass basis information between agents and brokers, the inconsistencies between existing systems, and the complexity of retrofitting these existing systems to ensure full compliance, would suggest that no penalties be assessed for five (5) years after the effective date for each type of security. In addition, penalty relief should be provided for the following situations:

- a. Penalties should apply only to covered securities acquired in an account either by purchase or transfer.
- b. No penalties should apply if the taxpayer changed its status after an account was transferred (for example, from a LLC being treated as a corporation to being treated as a corporation, or a nonresident alien who becomes a resident alien).

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- c. No penalties should apply to any securities that are not covered securities.
- d. No penalties should apply to any securities that are not widely traded on an U.S. exchange.
- e. No penalties should apply to any securities, such as foreign securities, which do not fall under the jurisdiction of this legislation.

* * *

We hope the information we have provided will prove useful. We again appreciate being given the opportunity to explain the complexity and costs of implementing cost basis reporting, especially for those business units that currently have no such programming, staffing, or processes in place. Please contact Ronald Long, Senior Vice President and Director of Regulatory Affairs or myself Todd May, Senior Vice President and Head of Shareowner Services if you would like to discuss this letter in more detail.

Very truly yours,

Todd May
Senior Vice President
Wells Fargo