FINANCIAL INFORMATION FORUM

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February 14, 2014

Electronic Delivery

Pamela Lew
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044

Re: Cat. No. 27980N - 2014 Instructions for Forms 1099-INT Interest Income and 1099-OID Original Issue Discount, published January 3, 2014

Dear Ms. Lew,

The Financial Information Forum (FIF) [1] on behalf of our Cost Basis Working Group ("the Group") is submitting this comment letter with respect to recent publication of the 2014 Instructions for Forms 1099-INT and OID[2]. The comments focus on treatment of accrued bond premium within the Instructions.

Calculation and Reporting of Accrued Bond Premium

Instructions for Forms 1099-INT and 1099-OID require reporting of accrued bond premium only when that premium offsets income paid in the reporting period. For non-OID bonds, this means that interest has been paid by the broker and that interest can be offset by bond premium accrued in the same reporting period. Although this instruction derives from the REG-102988-11[3], our members did not expect the IRS to require brokers to calculate accruals applicable to the reporting period. This requirement is a substantial new burden that our members will have great difficulty complying with for 2014.

The Group had submitted comments on the Final Regulations for Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options; Reporting for Premium[4] but had not included this issue because we had presumed that the IRS would allow brokers to report all bond premium accrued in the reporting period. At this time we would like the IRS to provide penalty relief to

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[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.
[2] Cat. No. 27980N, published January 3, 2014
[3] Final Regulations for Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options; Reporting for Premium, April 22, 2014
[4] FIF comment letter to Pamela Lew, Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options; Reporting for Premium [REG-102988-11], dated August 22, 2013

brokers who are unable to calculate and report the amount of accrued bond premium applicable for 2014.

Background on Tax Reporting Systems

Brokerage tax accounting systems today typically calculate daily accrual amounts as these amounts would be reported on the 1099-B in the event of a sale. However, the amount of bond premium that has to be reported on the 1099-INT if no sale is made during the reporting period is a completely different number accrued to a different date for each security. The 1099-B reporting and 1099-INT reporting are very different and we weren't expecting to have to do special calculations at the end of the year, specifically for INT reporting.

This reporting requirement will require brokers to reprogram tax reporting systems to perform calculations of adjusted basis for a non-OID debt instrument acquired at a premium based on a date that varies by instrument (last payment date) rather than a fixed date (the current date or the end date of the reporting period). The system will need to determine the last payment date based on the CUSIP of the security or receive the payment date as a new input parameter. Year over year, the end date of accrual reporting will have to be tracked by lot or security as that date will be the beginning date for reporting for the next reporting period as illustrated in the following example.

Example 1: An investor acquires a five year bond on 2/1/2014. The bond pays taxable interest semi-annually at a fixed rate of 5.625%. The investor buys a lot with a principal amount of $100,000 and pays a total cost of $105,000. At that price, the yield to the investor is 4.5%. The accrual schedule to amortize the premium paid by the investor is below.

Accrual Start Date	Beginning Cost in Period	Yield	Interest Expense	Interest Rate	Regular Income Earned	Period Ending Date	Amount to Accrue in Period	Ending Cost for Period
2/1/2014	105,000.00	0.045	2,360.96	0.05625	2,812.50	7/31/2014	-451.54	104,548.46
8/1/2014	104,548.46	0.045	2,350.80	0.05625	2,812.50	1/31/2015	-461.70	104,086.76
2/1/2015	104,086.76	0.045	2,340.42	0.05625	2,812.50	7/31/2015	-472.08	103,614.68
8/1/2015	103,614.68	0.045	2,329.81	0.05625	2,812.50	1/31/2016	-482.69	103,131.99
2/1/2016	103,131.99	0.045	2,331.77	0.05625	2,812.50	7/31/2016	-480.73	102,651.25
8/1/2016	102,651.25	0.045	2,308.14	0.05625	2,812.50	1/31/2017	-504.36	102,146.90
2/1/2017	102,146.90	0.045	2,284.18	0.05625	2,812.50	7/31/2017	-528.32	101,618.58
8/1/2017	101,618.58	0.045	2,284.92	0.05625	2,812.50	1/31/2018	-527.58	101,091.01
2/1/2018	101,091.01	0.045	2,273.06	0.05625	2,812.50	7/31/2018	-539.44	100,551.57
8/1/2018	100,551.57	0.045	2,260.93	0.05625	2,812.50	1/31/2019	-551.57	100,000.00

The bond is a covered security, so the broker will be required to report accrued bond premium annually. For 2014, the broker will only report accrued bond premium of $451.54, which is the amount accrued through 7/31/2014. All bond premium that accrues after 7/31/2014 is applicable to the interest payment that will be made on 2/1/2015 and is therefore under the new reporting requirements not reportable in 2014. In 2015, the broker makes two interest payments to the investor, so the bond premium reportable in 2015 will be that which is applicable to those two payment periods, which cumulatively is the period from 8/1/2014 – 7/31/2015. So, in 2015 the broker will report $933.78 in accrued bond premium, assuming the investor does not sell or transfer the bond to another broker.

These calculations, which take into account the payment periods for a bond, are clearly different than those that brokers do today to calculate accruals and adjusted basis through the current date. They require that the broker track the last payment date for every tax lot and perform separate calculations for the reportable amount of bond premium and adjusted basis for transfers. All the data to perform these calculations is available in either current tax lot records or the broker's security master, but the systems must be re-engineered to perform the calculations in this way and save the new data elements necessary to support tax reporting for future years and transfers of basis. Anomalies or exception processing would also have to be considered in new logic for inclusion in the tax reporting system.

In the event of a sale or other redemption, our members will report accrued bond premium on the 1099-INT through the date of the sale or redemption as illustrated below.

Example 2: The details of this example are the same as in example #1, except that the investor sells the bond on 10/06/2015. In 2014, the broker will report accrued bond premium thorough 7/31/2014 ($451.54). In 2015, the broker will report accrued bond premium of $1,113.71, which is the amount accrued through 10/05/2015. The investor realizes an additional amount of accrued bond premium in 2015 in the scenario because he / she also receives additional interest in the form of accrued interest received on the sale trade. The additional accrued bond premium amount ($179.93) may be used to offset a portion of the accrued interest realized upon sale ($835.69). This amount of accrued interest is also reportable by the broker on the 1099-INT.

Accrual Start Date	Beginning Cost in Period	Yield	Interest Expense	Interest Rate	Regular Income Earned	Period Ending Date	Amount to Accrue in Period	Ending Cost for Period
2/1/2014	105,000.00	0.045	2,360.96	0.05625	2,812.50	7/31/2014	-451.54	104,548.46
8/1/2014	104,548.46	0.045	2,350.80	0.05625	2,812.50	1/31/2015	-461.70	104,086.76
2/1/2015	104,086.76	0.045	2,340.42	0.05625	2,812.50	7/31/2015	-472.08	103,614.68
8/1/2015	103,614.68	0.045	835.69	0.05625	1,015.63	10/5/2015	-179.93	103,434.75

In this example, the amount of accrued bond premium reported by the broker conforms to the instructions for reporting in 2014 because all bond premium accrued for the investor in 2015 is also reportable in 2015.

Recommended Resolution

Implementing the changes necessary to tax reporting systems to calculate and report the amount of accrued bond premium applicable to the reporting period is a requirement that brokers did not anticipate and many brokers do not expect to be prepared to support in 2014. We could report the amount of bond premium accrued through the end of 2014 for covered securities, but we feel that reporting this amount would be confusing to the taxpayer given the ongoing requirement to report only the amount applicable to the reporting period. For those brokers who cannot complete the changes necessary to report only the amount applicable to the reporting period, we would prefer to not report any amount of accrued bond premium and to begin reporting the amount applicable to the reporting period for covered securities beginning in 2015. We ask that you offer penalty relief to brokers who are unable to report the amount of accrued bond premium applicable to 2014.

Reporting of Bond Premium

We find the requirement to report a single gross amount of accrued bond premium in Box 11 (Bond Premiums) of Form 1099-INT inconsistent with the requirements to calculate precise amounts of accrued bond premium attributable to the current reporting period.

In performing the calculations of accrued bond premium for covered securities, brokers are required to not only perform the accrual calculations, but also to consider payment dates and whether payments are made to determine the precise amount for each bond that is attributable to income for the reporting period. Then, after making those calculations, brokers are directed to combine all the amounts calculated on individual bonds into a single gross number to be reported to both the taxpayer and the IRS. This single number combines accrued bond premium for both taxable and non-taxable debt, instruments subject to AMT and those that are not, taxable instruments that are US government securities and those that are not.

If the taxpayer holds more than one of these types of instruments, a single gross value reported on the 1099-INT is virtually useless. The taxpayer will still have to perform the accrual calculations for the individual securities in order to report their federally taxable income expense and taxes correctly for each type of instrument. And for the same reasons, we do not understand what value this gross amount of accrued bond premium provides for the IRS. We believe that the amount of accrued bond premium reportable on the 1099-INT should be split into at least two amounts (amounts accrued on taxable and non-taxable instruments) to be useful to taxpayers.

If the intention is to provide information to taxpayers that can be easily transferred to taxpayer's return, we think that the amount of accrued bond premium should be split into four separate amounts:

- Premiums on bonds that accrue taxable interest (non-government).
- Premiums on bonds that pay non-taxable interest not subject to AMT.
- Premiums on bonds that pay federally taxable interest (government instruments)
- Premiums on private activity bonds with accrued premium subject to AMT.

Summary

The Group recognizes that it missed an opportunity to identify this issue impacting the tax systems earlier in the cycle while reviewing the Final Regulations. However, it did not become clear to the Group until Draft Instructions[5] published in November were carefully analyzed. We request relief from reporting of accrued bond premium for 2014 so that we can have adequate time to modify tax reporting systems for this requirement.

We are currently preparing additional comments on the reporting of bond premium for defaulted bonds and on transfer requirements that become effective in 2015. However, the Group feels the urgency of this request for relief demands that this request be submitted immediately.

Regards,

Darren Wasney
Program Manager
Financial Information Forum

[5] Draft 2014 Instructions for Forms 1099-INT and 1099-OID, Cat. No. 27980N, dated November 15, 2013