FINANCIAL INFORMATION FORUM

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Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-17), Room 5203
P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044

Re: Notice 2009-17

Dear Mr. Schaeffer,

The Financial Information Forum (FIF)[1] would like to take this opportunity to offer additional feedback on IRS Notice for Comment 2009-17. The FIF Cost Basis Working Group includes broker-dealers and service bureaus responsible for implementing the new cost basis requirements added in section 403 of the Energy Improvement and Extension Act of 2008, Div. B of Pub. L. No. 110-343, 122 Stat. 3765. Given the short comment period, FIF submitted a preliminary comment letter[2] outlining several implementation issues. In order to address all of the questions raised in the IRS Notice, we have prepared the following comment letter focusing specifically on the questions asked in the Notice.

FIF Cost Basis Working Group Response to IRS Notice 2009-17 Questions

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.

To avoid confusion, 'middleman" should be defined in the same manner as under the existing 6045 broker reporting rules. The broker responsible for filing the 1099 should be responsible for basis reporting and the 'multiple broker' rule and 'cash on delivery' rules in 6045 should be

[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] See initial FIF Comment Letter on IRS Notice 2009-17 , dated February 27, 2009

applied. Although some firms may hire vendors to calculate basis information, these entities should not be considered middleman as they are mere agents of the broker.

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

Any entity that takes possession of a covered security on behalf of an investor should be considered "applicable persons." These include:

- Broker Dealers
- Custodian Banks
- Mutual Funds
- Transfer Agents
- Stock Plan Administrators
- Issuers

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

Correctly applying the effective date is a concern only for the two year phase-in period after which all securities are covered. During this interim time, the issuer definition should be the classification of record. In dealing with hybrid securities, e.g., convertible bonds, standards should be established in order to have consistent classification. Without established standards, we believe issuer descriptions may be nebulous and open to different interpretations.

If the IRS chooses to reclassify an instrument, official notice should be published. In no event should penalties accrue to broker/dealers or taxpayers who relied upon the issuer's inaccurate classification.

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.

As part of the client on-boarding process, the default cost-basis methodology should be defined by a broker and provided to the client via their new account disclosures. Default accounting method could be included on 1099 Form. Information can also be accessed on statements / online. Customers should be able to notify brokers of a change verbally or in writing. Specific lot identification on a given trade could be captured on trade confirmation, monthly statement, year- end tax report or a combination of those means.

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.

Customer elections should be facilitated using normal servicing channels. Cost basis determination should be chosen or reconfirmed at the time of sale or any other reportable event. Any change of basis method that is selected by a client should not impact settled transactions. Any change requests should be made on a go-forward basis.

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 response to Question 5 above, the IRS should provide clarification on how often a client can change their basis elections. If customers are allowed to change their basis determination method from average cost to another method, it will present a very significant technical challenge to recalculate the customer's basis because it requires the broker to restate lots and reinvest shares. This makes reconciliation extremely challenging and also increases the likelihood of discrepancies between broker and customer reporting.

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

Allowing clients to choose the basis convention on an "account by account basis" enables the individual customer to make cost basis choices at the account level. We consider an individual brokerage account as one with a unique account number; examples include individual accounts, joint accounts, and custodial accounts. Individuals that have more than one account with a broker would be able to choose different conventions for each account. Brokers can accommodate this request but should not be responsible for reconciling cost basis conventions across multiple accounts held either at their firm or across firms. As a result of applying cost basis on an "account by account basis," wash sales across accounts are the clients' responsibility.

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").

A "sponsored DRIP plan" should qualify. This implies a direct plan with the corporate sponsor. There are different opinions as to what the scope of DRIPs should be beyond sponsored DRIPS. IRS guidance is required.

If broker dealer plans are included in the scope, it is our belief that the option to use average cost for DRIP positions is at the broker's discretion.

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.

Clarification on the definition of a DRIP plan is required to address this question. If DRIP plans include those offered through a brokerage account, the 2012 date should apply. The difficulty is in applying an average cost method to DRIP shares and another method to originally purchased shares and full shares purchased directly by the client. Because of the differences in effective dates (equities in 2011 and DRIP shares in 2012), brokers should be allowed to begin reporting basis in 2012 where a client elected DRIP on the original shares and the reinvested shares.

Additional time would be helpful to separate tax lot accounting for the same CUSIP within a single account; comingling of covered and uncovered lots (Non DRIP and DRIP) of the same CUSIP purchased in the same year will add complexity. To minimize this complexity, definition of DRIP should also be restricted to sponsored plans.

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

Subsequent additions to DRIPs by purchase or transfer need to be kept separate from a cost basis reporting perspective. See reply to #8 and #9 above.

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.

See reply to #8 and #9 above. The statute, as written, introduces the new potential requirement to bifurcate average cost positions into two distinct holdings (pre / post effective date). This presents significant system challenges and we recommend consideration be given to combining reliable information on pre / post effective date lots if average cost is used. If pre effective date lots are included this should be disclosed as such.

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.

- In order to promote consistency between customer reporting on Schedule D and broker reporting on the 1099-B, the IRS should review both forms and make them substantially similar.

- Providing additional cost basis information will require a redesign of Form 1099-B. There is a tradeoff between requiring multiple 1099s for a single transaction versus significant modifications to the existing form. Either approach results in new complexities for both the broker and the taxpayer in reconciling and reporting. From a data processing perspective, either approach will require significant changes to current systems. A decision should be made and rules published soon (by the end of 2009), so that we have adequate time to design and implement a solution.
- The inclusion of cost basis information on not covered securities should be at the broker's discretion. The 1099-B should allow for the indication as to whether securities are covered.
- Information from multiple sources should be identified

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

Broker reporting should include the effects of client specific lot identification. The client is required to use the data that the broker reports. Individual clients should be made aware that if what they see on their broker statement or confirmation of trade is wrong, the issue needs to be addressed as soon as practicable and certainly prior to their tax filing.

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

Brokers should maintain cost basis data and make it available to customers for reconciliation for 3 years. Any reconciliations should be the responsibility of the taxpayer.

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.

Client decisions on cost basis methodology at the time of a trade should not be modified after settlement date. Any change requests should be made on a go-forward basis. Communication of this requirement will be essential to avoiding issues with clients seeking to retroactively change their cost basis methodology after receiving statements or during tax preparation. Significant development effort would be required to automate the retroactive application of cost basis methodology.

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.

Identical securities should be defined as securities which have the same CUSIP/ISIN.

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

Options are not covered securities based on the legislation until 2013. Brokers should have the option to provide reporting on uncovered securities on Form 1099B and be disclosed as such.

This is an issue requiring broader industry discussion. See response to Question #12.

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.

Transition rules are required to address how a short should be reported when it was entered into pre-effective date but closed post-effective date. It is our belief that only short positions that are opened after 2011 should be reported.

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.

From a mechanical standpoint, brokers will need to establish procedures to handle each of these types of basis 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.

IRS guidance is required.

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.

It is imperative that an electronic utility be established for this purpose. Reliance on any manual means of cost basis transfer information would be a step backward from a cost, efficiency and accuracy perspective. The benefits of a centralized utility for transferring securities have been well established with the use of ACATS and CBRS. While currently the Cost Basis Reporting Service (CBRS) is an optional service of ACATS, requiring mandatory use of the tool would ensure consistency across the brokerage industry. Similar tools should be developed to offer other industry participants (e.g., transfer agents) access to the system for input and receipt of cost basis information.

ACATS has already proven extensible to the mutual fund industry with the launch of ACATS Mutual Fund Service. Industry participants (e.g., custodian banks, transfer agents) and NSCC should be engaged in a discussion regarding participation in ACATS/CBRS or the creation of similar functionality to allow all relevant parties access to transfer information. Modification to NSCC/DTCC membership models and systems required to accommodate this functionality should be reviewed in order to minimize the implementation and on-going costs of using the service. Functional requirements include:

- Standard data fields required for cost basis transfer
- Reconciliation process between transferring parties
- Penalty relief for receivers of cost basis reporting data when using the system
- Notification of both parties as to missing or incomplete cost basis information as part of transfer
- Support for transfer of corporate actions/wash sale information
- Support for transfer of DRIP cost basis reporting

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.

Fifteen days should be adequate when using a central utility (e.g., NSCC ACATS CBRS System) to transfer positions and basis. Transfer of adjustments to basis resulting from corporate actions and post-year-end income reallocations could also be facilitated through this kind of system. However, even an existing system like ACATS CBRS will require significant changes to support all these new requirements. It is imperative that final rules be published as soon as possible and certainly by the end of 2009 so that work can begin to support these new requirements.

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.

Yes, they should apply equally.

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

Electronic transfer reporting is a necessity to ensure that transfer of cost basis is handled efficiently. Participation in a centralized utility should be required of all applicable persons. See response to Question #21 for additional details on electronic transfer reporting requirements.

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

Broker dealers and transferring parties utilize experienced third party service bureaus today that have demonstrated their ability to address a variety of back office functions including facilitation of transfers, books and records maintenances and other back office processing functions. Broker dealers using third party services understand that the compliance obligation rests with them whether they use in-house or vendor solutions.

As part of a transfer, the party responsible for the basis is the transferring party. The transferor may utilize a third party vendor; however, the transferor is responsible for sending the basis to the transferee broker.

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, appropriate available information should be provided. It should be disclosed if the transferred securities are not covered securities.

Issuer Reporting

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

Issuers should provide all relevant information required to determine the cost basis impact - the allocation between income and return of capital or the percentage of basis allocation between two or more entities. This information should be disseminated within the 45 days set forth in the new rules and issuers should be held accountable to meet these deadlines.

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

The timeline of 45 days specified in the rule is a reasonable requirement and issuers should be held accountable for meeting this deadline. Manual reporting of this information, such as reporting on a website, is inefficient and will cause brokers to have to check a website or other public avenues every day or possibility more than that. We suggest a centralized reporting repository to collect the information and make it available to market participants.

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.

Since foreign issuers are not subject to U.S. securities law, brokers will make a best efforts basis to determine the impact of corporate actions on foreign securities. The IRS should provide penalty relief if basis-changing corporate actions are incorrectly applied. In order to minimize the liability of reporting inaccurate information, these securities could be flagged with a statement indicating that the security is a foreign issue.

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.

It is not possible for the receiving firm to know for certain whether basis has or has not been adjusted for a pending corporate action. The transferring broker needs to be responsible and send an amended basis record if the basis of a security it transferred needs to be adjusted for a corporate action. The best way to facilitate that information transfer is for the transferring parties to exchange relevant information using the electronic utility (e.g., CBRS). See response to Question #22.

Broker Practices and Procedures

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

Brokers should not be responsible for verifying the reasonableness of data that they acquired from another source (e.g. data transferred from another broker or acquired from a customer). Brokers should be accountable for data generated from their own cost basis systems. Cost basis records should be maintained for 3 years from either the sale or transfer of the tax lot.

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.

Broker systems will need to identify the source of the cost basis as part of their data storage policies and disclose to the customer when a security is "not covered." It is important to distinguish what would be useful to customers and what should be reported to the IRS. Brokers may choose to accept basis data for an uncovered security (e.g. a security acquired before the effective date) from a customer and report this information back to the customer on statements, however we do not believe that brokers should be required to report such information on securities that are not covered securities.

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

Use of an automated transfer process needs to be mandatory. The electronic utility should include functionality to alert both parties when basis information is missing or incomplete. There should be accountability for failure to transfer cost basis information using the mandated mechanism.

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.

Retaining cost basis received as part of a transfer on non-covered securities should be optional. Use of this information should be at the discretion of the transferee broker. With regard to reporting information on a reportable security from a transferor who is not subject to the transfer reporting requirements we would suggest flagging this data if used.

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

Issuers must be held accountable to meet the requirement to provide basis adjustments in a timely manner. In these cases, brokers could include an indicator noting that there needs to be an adjustment based on a corporate action that happened at a specified date e.g., "not adjusted for corporate action." If the issuer is untimely, the broker should make the adjustment, even if this means a corrected 1099.

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

Brokers should not be subject to penalty as a result of inaccurate or untimely information provided them by issuers, transferors or their clients. Consideration should be made during the transition period with respect to penalties. We suggest a reprieve with respect to the assessment of penalties for twelve months after each respective effective date.

Ensuring an efficient implementation of the new cost basis requirements requires further dialogue among industry participants especially given the level of cross-party communication that will be required to facilitate the transfer process. We look forward to participating in this dialogue with the Internal Revenue Service and other industry participants at your earliest convenience.

Sincerely,

Manisha Kimmel
Executive Director, Financial Information Forum