# FINANCIAL INFORMATION FORUM

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Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station,
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Re: FR Doc. 2009-29855 Filed 12/16/2009

Dear Mr. Schaeffer,

The Financial Information Forum (FIF) [1] appreciates this opportunity to respond to the notice of proposed rulemaking published by the U.S. Department of the Treasury Internal Revenue Service (IRS) on December 16, 2009 regarding basis reporting by securities brokers and basis determination for stock. While the document did provide some clarification and additional insight into several of the open issues FIF has presented in previous correspondence[2], the document has also served to amplify our concerns regarding the expected timing of implementation. To briefly summarize the current state of these rules from FIF's perspective: the first effective date for the new rules is January 2011[3]; we do not yet have final regulations to guide development, testing and education efforts; and, many implementation details remain ambiguous and/or highly problematic as proposed.

Given the extreme complexity in understanding and programming these requirements, FIF continues to believe that the effective date of basis regulations should be 18 months after the issuance of final guidance. While we fully understand the IRS's position and the reality of statutory limitations, we ask that the IRS in turn consider the reality of designing and implementing new intricate systems that require significant collaboration among numerous constituents with varying degrees of sophistication and automation.

With the goal of implementing the new requirements correctly, it was suggested during our conference call with Jeanne F. Ross, U.S. Department of the Treasury on December 16, 2009 that narrowing the scope of initial implementation will help to ensure a successful launch with an increased level of accuracy that is acceptable to all, including the IRS, financial services firms, and the taxpayers. To that end, FIF respectfully submits this letter with recommendations for deferral of certain aspects of the rules, and modifications to others.

This letter describes the consensus view of Financial Information Forum's Cost Basis Working Group[4] on several topics that we believe should be:

a) "Carved out" from Phase 1, January 2011 implementation;
b) Modified or streamlined to reduce confusion and increase the likelihood of successful implementation; and / or,
c) Examined more carefully to identify any unintended consequences or conflicts the proposed rule may have with existing operational functions and securities law requirements.

In addition, we have included a set of sample questions that require further clarification and guidance from the IRS before the industry can implement the regulations as they were intended. This letter's intent is to highlight the most significant implementation challenges and most significant opportunities to narrow scope in order to be successful in 2011. There are also many more issues of less magnitude, but equally in need of clarity. To reach resolution on these issues, we hope to arrange a meeting or conference call with the IRS as soon as is reasonably possible.

FIF's key implementation concerns and recommendations are presented in Table 1.

**Table 1. Summary of Key Implementation Concerns and Recommendations**

| Topic | Key Concerns | Recommendations | Comments |
|---|---|---|---|
| Transfers | › Existing CBRS participants will have only months to program to new DTCC file requirements that will not be finalized until after final basis regulations are issued<br>› Hundreds of financial custodians do not currently participate in CBRS representing 30 – 40 % of all transfer volume (~1.4M per year)[5]<br>› Non-standardized information will be passed manually by firms not using CBRS which is extremely labor intensive and increases the chances of corrupt data<br>› Passing corrected basis requires rule clarifications and significant industry coordination and software development | › Defer to 2012<br>› Eliminate serial number requirement<br>› Do not exempt certain parties from having to adjust transfers for corporate actions<br>› Limit corrections to those that occurred in the current or previous tax year | › Nearly all gain/loss data for stock will be captured without transfer activity<br>› Only 3% of active accounts transfer per year and only a fraction of this data will include covered basis under the regulations in 2011 |
| Gifted and Inherited Securities | › There are significant system challenges to identify gifts and integrate transfer systems with cost basis systems<br>› There are challenges to maintain new data fields needed for gifts and to perform complex calculations when shares are disposed<br>› Delays with executors notifying brokers of basis instructions creates indefinite need to correct basis including corrected transfers / 1099s | › Allow for default rules to carry-over basis for gifted stock and step up basis (*i.e.*, fair market value at the time of death) for inherited stock<br>› Allow penalty relief for broker to rely upon instructions from tax payer / executor | › Default rules are workable for the broker<br>› Default rules will provide accurate data for the vast majority<br>› Default rules will minimize need for open ended correction requirements in the case of delayed basis instructions from estate executor |
| Short Sales | › Insufficient data<br>› Transfers<br>› Back Up Withholding | › Defer to 2012<br>› Report year end 2010 open short sales as part of year end 2010 1099B reporting cycle | › Many firms are unable to begin collecting needed information effective 01-01-2010, in order to meet 2011 |

| Topic | Key Concerns | Recommendations | Comments |
|---|---|---|---|
| | | › Continue back up withholding as is, at the time of sale | implementation<br>› Significant system changes are required to trigger and track withholding at the time of a closing purchase<br>› Withholding at time of closing may create margin calls to satisfy tax withholding |
| Wash Sales | › Circumstances under which wash sale rules apply and when they do not<br>› Transfer issues arising from tracking holding period and disallowed losses<br>› Differences in the manner which brokers and taxpayers will track and maintain cost basis | › Defer implementation to 2012<br>› Require IRS clarification and rule revisions<br>› Re-examine the nature of an "account" and "identical" securities | › Requires clear definition of account<br>› There are substantial system and customer/taxpayer experience issues that are likely to take more than a year to address properly |
| Foreign Securities and Non-sponsored ADRs | › Issuers are not required to provide cost basis information<br>Impact of currencies | Defer to 2013 and provide penalty relief for "best efforts" | › Corporate actions information not available or subject to interpretation<br>Currency transactions aren't currently captured in most cost basis systems |

The following provides an explanation of these recommendations, with additional detail presented in the Appendices.

## Transfers

Based on data collected from industry studies[6] concerning the volume of active brokerage accounts relative to transfers per year, only 3% of active brokerage accounts transfer. With the 2011 effective date, we can assume that within this 3%, a smaller fraction include covered stock under the regulations. FIF believes that a deferral of transfer requirements for one year will result in less than 1% of covered transactions being omitted from 2011 reporting.

### Standardized, Electronic Formats

While the industry has been working diligently to adjust current automated procedures to address the proposed requirements to pass cost basis information with account transfers, time has run out to meet the January 2011 deadline.

As an industry utility, the Depository Trust Clearing Corporation (DTCC) is expanding the capabilities of its Cost Basis Reporting Service (CBRS)[7] to incorporate the fields needed to pass information electronically. DTCC is also planning to allow non-DTCC participants to utilize the service. But without finalized rules, new specifications cannot be completed. Assuming rules are finalized in June 2010,

six months does not provide adequate time for DTCC to publish final CBRS file specifications and the entire industry to program and test appropriately.

There are hundreds of entities upon whom financial services firms will rely to obtain critical cost basis information, which do not participate in CBRS currently (or any other automated service). A project to participate with CBRS for the first time for most entities is a 6 – 9 month proposition. Based on this, the industry is far from having a universally adopted mechanism to transfer basis in a standardized and automated system. Lack of a universally adopted transfer utility presents great risk in data corruption and also huge operations complexities for every firm to manage. Appendix I provides further discussion of the necessity of an electronic transfer system.

**Transfer of corrected cost basis information**

The proposed regulations have exacerbated the challenges with a new requirement to include a serial number on each tax lot indicating the most recent corporate action included in the basis being transferred.

On one hand the regulations state that the delivering broker is accountable for sending corrected basis when necessary after the initial transfer. On the other hand, the serial number requirement implies that the receiving broker must perform some reconciliation process to determine if the basis is inclusive of all required issuer adjustments. FIF believes that all custodians should be required to update basis for corporate actions that occur for stock held in their custody and that any exception to this should not be granted. The alternative is a costly impact to the entire industry of having to reconcile corporate action serial numbers which far outweighs the costs associated with requiring all custodians to update basis when necessary. As a result, to avoid confusion with accountability for dealing with corrected basis, FIF believes the delivering firm should bare the sole responsibility for sending corrected basis and the receiving firm should have penalty relief if the deliverer fails to meet this obligation.

The requirement for the transfer of corrected basis compounds the need for the entire industry to adopt a standardized automated channel (CBRS). Only CBRS offers the reconciliation capability to link the corrected basis received to the original transfer received. Manual sending of corrected basis would make the data entry work even more error prone and more labor intensive.

Finally, the unlimited time period for firms to send corrected basis is also problematic. It will require an open-ended database to reconcile basis corrections and transfers. Also, when a firm transfers out, the account is often closed. Sending and receiving basis between closed accounts will present other system issues. To provide some limits, FIF recommends that transferring of corrected basis only be required for corrections that occur in the current or previous tax year. This limit will still result in capturing nearly 100% of all corrections.

**Defer Transfers**

Given the circumstances and the narrow timeframe for implementation, it is unreasonable to assume the entire industry will be ready for January 2011. Those that are ready will be forced to deal with large gaps in coverage. There will be firms performing cost basis reporting for the first time and it is extremely difficult for firms without existing cost basis systems to accept and send basis by 2011. Most damaging will be the contagion effects of unreliable and corrupt information being passed from one firm to another. For these reasons and the limited account population impacted (less than 3%), we

strongly recommend that required implementation of the transfer activities be deferred until 2012. Further detail regarding the issues associated with transfers is provided in Appendix I.

## Gifted and Inherited Securities

The requirements to calculate and transfer basis for gifted and inherited securities come as a surprise to those of us who have been involved in the legislative process that led to the Proposed Regulations. We do not agree that calculating basis for gifted and inherited securities "fall within the plain language of the statute" or that "the proposed regulations provide workable rules to minimize complexity". These requirements as presented in the Proposed Regulations are enormously complex to apply, particularly when considering customers residing in fifty states that have varying rules for determining the date of a gift or the basis adjustments allowed for property held jointly in the event of the death of one of the joint owners. For gifted securities, we believe that there is a reasonable alternative that will significantly reduce the complexity of the reporting requirements. For inherited securities, we believe that there is also a reasonable alternative for estates in the name of a single decedent.

**Inherited Securities**

With respect to basis adjustments for securities held solely in the name of a single decedent, we recommend that the broker be allowed to step up the basis of the securities held in the sole name of the decedent to the fair market value as of the date of death. The date of death is easily documented with a death certificate and obtaining such documentation is normal brokerage procedure in the disposition of assets held for a decedent. Such a procedure may even be a welcome service to the authorized representative of the estate, who would only need to provide additional instructions to the broker regarding basis adjustments if some additional adjustment were necessary. This procedure would simplify the basis adjustments required of the broker and, in most cases would result in the correct basis information being reported or transferred upon disposition of the estate's assets. We believe that this alternative would significantly reduce the incidence of corrected transfer statements or corrected 1099s for this kind of account.

With respect to securities held for multiple tenants where one tenant becomes deceased and the survivor or survivors inherit the securities, we see the new regulations as introducing far more complex requirements. In these cases we believe that the broker has no alternative but to rely on the authorized representative of the estate to provide instructions for basis adjustments as described in the Proposed Regulations. However, as a practical matter that representative is likely to be the surviving tenant, who has full legal access to the assets in joint name and no immediate need to inform the broker of the basis adjustments required or even that the other tenant is deceased. If you add to that fact the complexity of determining basis adjustment for different tenancy relationships under various state laws, we expect that in such situations, securities are likely to be sold or transferred before the taxpayer provides the broker with information necessary to adjust basis. These circumstances will result in the need for the broker to issue corrected transfer statements and / or corrected 1099s, but we do not see any means to reduce this burden on the broker short of defining the securities in these cases as uncovered.

**Gifted Securities**

With respect to gifted securities, we feel there is also an opportunity to reduce the burden on the broker and still achieve the goal of the legislation. The proposed regulations require that the broker obtain, maintain, transfer and eventually use both the donor's basis and the fair market value as of the

date of the gift in order to calculate the gain or loss for a gifted security. The requirement to obtain the date of the gift, the fair market value as of that date and transfer that information in addition to the donor's basis is a significant burden which we believe serves little if any purpose. The fair market value (FMV) as of the date of the gift is information which is required to determine the amount of any loss that may be allowed for the recipient of the gift when the recipient sells the security and if the recipient is a taxable entity. However, such a circumstance (the recipient of gift realizing a taxable loss upon the sale of a gifted security) is rare and does not justify the burden of obtaining and transferring this additional information for every gift of securities processed by a broker.

A large percentage of gifted securities are gifted to tax exempt organizations which would not be eligible to claim a loss. However, a broker delivering a security to another broker as a gift could not be certain of the tax status of the recipient and therefore would still be required to obtain and transfer the additional information. Second, for gifts to a taxable recipient where the FMV is less than the donor's basis, the donor would be better advised to sell the security themselves, realize the tax benefit of loss and make a gift of the same value in cash, rather than give the security to a recipient who would not be able to realize the benefit of the loss. To accommodate the rare circumstances where a taxable recipient sells a gifted security for an amount that is less than the donor's basis, we believe that the broker should have penalty relief and be allowed to override the default carry-over basis if the tax payer provides these instructions. We therefore recommend that brokers only be required to maintain and transfer the donor's basis for gifted securities.

## Short Sales

The application of the cost basis regulations as currently proposed for short sale transactions will create difficulties in meeting the conversion deadline of January 1, 2011. Further, potential conflicts may arise for brokers in the ongoing application of the regulations as they attempt to comply with tax withholding obligations and securities laws.

**Transition Issue**

In the case of a short sale, section 6045(g)(5) provides that gross proceeds and basis reporting under section 6045 is generally required for the year in which the short sale is closed. The proposed regulations implement this change to reporting of short sales by requiring brokers to report all short sales opened on or after January 1, 2010, for the year in which the short sale is closed. For sales closed on or after January 1, 2011, using covered securities however, the proposed regulations require brokers to report both the information concerning the securities sold to open the short sale and the information concerning the securities acquired to close the short sale on a single return of information. This requirement places certain basis tracking requirements on brokers in 2010 related to the open short position and also requires brokers to develop a program to suppress 1099B reporting for open short sales at year end 2010. Given the already extreme short time expected to exist from final regulation publication to implementation, the FIF believes that the better approach is to report all open short sales at year end 2010 during the 2010 1099B cycle and treat all subsequent purchase transactions to cover those sales as uncovered securities. This treatment would be consistent with the proposed regulations' treatment of short sales closed after January 1, 2011 with other types of uncovered securities. FIF recommends that the proposed rules be modified to state that securities acquired or purchased after January 1, 2011 to close a short position that was opened prior to January 1, 2011 are uncovered securities.

**Back Up Withholding**

The proposed regulations modify the backup withholding rules to provide that backup withholding can occur only at the time the short sale is closed and becomes subject to reporting under section 6045(g)(5). Changing from the current approach of withholding at the time of sale to the time of closing out the short position will create issues for recordkeeping and may even impair a broker's ability to comply with securities and tax laws simultaneously. The tracking of the withholding obligation from time of sale until the final position is closed will be onerous. It will require reprogramming systems to withhold money simultaneous to purchase transactions for amounts that relate to historic sale prices. Additionally if the sale has been transferred from another broker, the possibility exists that incorrect withholding will occur as only the adjusted basis is required to be transferred and not the original short sale price. A further complication arises if the short sale becomes very profitable with a decline in the market value of the position. The situation may exist that the twenty-eight percent withholding amount on the original sale may not be available in the account. This would create a margin call after the closing purchase is executed in order to satisfy the withholding obligation. To alleviate these circumstances, FIF believes the withholding obligation should continue to be at the time of sale when proceeds from the sale are available in the account. This can be facilitated by an additional box added to the 1099B tax form to handle situations where a short sale remains open across tax years. When checked with only the reporting of a sale on the form, this indicator would identify that an open short sale has had withholding, but remains open. Subsequently when the short sale is closed, a 1099B tax form would be filed in the normal course of business with gain or loss information but no amounts indicated for tax withholding.

## Wash Sales

As the industry examines the potential impact of the proposed wash sale reporting, it is becoming apparent that there are many unanswered questions that are increasing in urgency as the timeframe for implementation is decreasing. It is for this reason the FIF is requesting that the IRS provide further guidance and delay the reporting of basis on wash sales until 2012. The following is a bulleted list of concerns that FIF believes will require clarification from the IRS before industry consensus in their implementation can be established, substantial software development work can begin, and taxpayers can be educated on the many impacts this reporting will have on them.

- Does the repurchase of dividends or selling of fractional shares create a reportable wash sale?
- Can an end of year correction (return of capital) create a reversal of a wash sale adjustment during the year?
- Given that the proposed regulations provide that any stock that is a covered security (within the meaning of section 6045(g)(3)) is treated as held in a separate account from any stock that is an uncovered security regardless of when acquired, how should a broker treat covered and uncovered securities with the same CUSIP in the same brokerage account for wash sale purposes?
- How should a broker treat DRP securities and non-DRP securities in the same brokerage account with the same CUSIP for wash sale purposes?
- In order to accurately report whether a gain or loss is long-term or short-term, it will be necessary to track holding periods for wash sales by counting days that comprise the holding period. Must this information be passed on with account transfers? The proposed regulations only provide for transferring "…the date for computing whether any gain or loss with respect to

the security is long-term or short-term…" Tracking and transferring these days for determining the type of gain or loss will create system challenges.

- Given that the wash sale basis reporting rule applies only to securities in the same account, what is the impact of this limitation on transfers of securities from one account to another? Transfers within the same firm for the same customer?
- As currently proposed the form 1099B requires the reporting of both the disallowed wash sale loss and the reported gain or loss from the specific sale being reported. Many systems track wash sales by adjusting the actual basis of the securities in question as the IRS regulations require. To mandate a change that requires adding losses together and carrying that product forward for 1099B reporting purposes (as well as transferring that information to another broker) while not carrying the underlying security in a net cost basis position is highly problematic. Critical cost basis data for transfers will be lost, a new category of transfer information (the aggregate wash sale loss disallowed) will have to be established and transferred, and taxpayers will be confused seeing a reported basis that only reflects the most recent purchase as well as two loss numbers on the 1099B which must be added together. If the intent of the proposed regulations is that the brokers are to maintain two sets of basis information, gross and net, then it is back to the drawing board from a systems perspective to track wash sales for 1099B reporting purposes and basis transferring purposes.
- FIF members have identified more than 60 scenarios that can create a wash sale and each will require programming. There is no current vendor that sells a product that is fully compliant with the proposed regulations and it is doubtful that this can be accomplished for any system by the January 1, 2011 implementation date.
- The proposed broker reporting of wash sales has a different set of requirements than is placed on the public for reporting wash sales on their tax returns. The ability for the industry to understand to address these differences and develop systems to support them and facilitate taxpayer compliance will be very difficult in the current timeframes.

## Foreign Securities and Non-Sponsored ADRs

Foreign securities and American Depository Receipts (ADRs) that are non-sponsored (not listed on a U.S. exchange) are extremely challenging to provide cost basis information for two primary reasons:

1. Foreign issuers are not required to provide corporate actions information in English or in any standardized format, and they are not posted to a single repository. Reporting cost basis on foreign securities will be onerous and far from accurate as firms will struggle to research and translate corporate actions activity from a multitude of foreign companies' websites.
2. The need to segregate a gain or loss on the currency component of a transaction from the cost basis of the underlying security adds a layer of complexity.

While this can be achieved on a "best efforts" basis, there is no certainty that corporate actions will be properly interpreted or applied.

Other difficulties are presented when the results of a foreign corporate action impacts U.S. investors differently than others. One specific example involves corporate actions on companies based in the U.K., where prospectus information frequently indicates that there are no recommendations for U.S. Federal tax consequences (Different versions of a prospectus are often distributed depending on the geographic region). There have been situations arising as a result of a corporate action, where holders of foreign ordinary or ADR shares may receive a cash distribution in lieu of securities, if the security to be received is not eligible to be held in a U.S. client's account. In practice, the shares that are ineligible

to be held in U.S. accounts are sold and proceeds are ultimately passed to U.S. brokers for distribution to individual clients. These cash amounts are reported on the 1099-B as gross proceeds, but from a cost basis and bookkeeping perspective, the securities that were sold had never been held by the U.S. taxpayer and had never been included in the U.S. broker's back office system or cost basis system.

For these reasons we request that foreign securities and non-sponsored ADRs remain uncovered under the new rules. If this approach is not feasible, we ask the IRS to recognize that the industry cannot formulate a plan to address these issues until at least 2013. Even with a delayed implementation, we can report only on a "best efforts" basis and will require penalty relief due to the lack of and inconsistency of information.

## Summary of FIF Position

In summary, these recommendations are offered notwithstanding our FIF members' strong continued support for a one-year delay of the regulations in their entirety with a first effective date for equities of January 2012. As a less preferred alternative, we have proposed that the scope of the initial implementation be reduced to allow the industry to focus on completing what represents the main body of the regulations. We have also posed sample questions in Appendix II which require clarification and guidance from the IRS in order to ensure the regulations are interpreted and applied consistently across the industry. A meeting with the IRS or written response to these questions is critical for a successful industry implementation.

Representatives from FIF will be in attendance at the public hearing scheduled on February 17th at which we look forward to presenting our members' positions on the topics highlighted in this letter. We appreciate the opportunity to interact with the regulators and industry participants in this forum in order to ensure that the final regulations can be implemented.

Regards,

Tom Jordan
Advisory Committee Chair
Financial Information Forum

CC: Martin Bentsen, Chief Operating Officer, Computer Research Inc and Co-Chair, FIF Cost Basis Working Group
Brian Godfrey, Vice President Client Reporting Operations, Charles Schwab and Co-Chair, FIF Cost Basis Working Group

# Appendix I - Transfers

**Need for Electronic, Standardized Formats**

Presently, only 62 out of 182 (34%) eligible firms participate in CBRS (eligibility requires use of ACATS or Automated Customer Account Transfers). Non broker dealers such as transfer agents do not participate on ACATS and as a result none use CBRS presently.

With only an estimated 60 – 70% of the industry's account transfers facilitated electronically leveraging CBRS, approximately 1.4 million transfers per year are transferred outside of CBRS today. This fact, combined with the severe time constraints based on the timeline for final regulations and final CBRS file specifications, indicate that the financial services industry will not achieve a standardized, automated transfer service by January 2011. The challenges involved in non-automated transfer processing and transfer of corrected cost basis information are discussed below.

**Challenges of a Non Automated Transfer Process**

To the extent CBRS is not utilized given the circumstances cited above, a manual process for transferring basis is extremely problematic, if not infeasible.

One of the key features of CBRS is that it is integrated with ACATs and as such the cost basis data can be reconciled to specific identifiable tags in the ACAT so the receiver knows exactly to which position the cost basis belongs. For example, CBRS clarifies which firm the transfer came from, which transfer record the basis corresponds to, and offers error reporting in instances where the basis information doesn't correspond to the asset received in the transfer. While a written transfer form would supply some of this same information, each firm will need to support a manual reconciliation process to determine which basis they have received as well as which basis they have not received. When a client decides to consolidate their accounts at one firm it is commonplace to have multiple transfers occurring from several firms which include the same holdings.

The manual data entry that is required in a non-automated process is incredibly labor intensive and error prone. It is not uncommon for a single security position to be comprised of dozens of tax lots, and for an account to hold dozens of positions. Therefore, one account transfer may involve the manual entry of hundreds of tax lots. Manual data entry for larger firms will equate to several thousand tax lots per day. Errors made in this process will compromise data integrity and drive broker / client reconciliation issues. In addition, firms need to manually reconcile the data they have received and follow up with the delivering firm if they received incomplete or irreconcilable data. This requires every firm to set up phone teams to support inbound and outbound calls regarding cost basis data. Information passed on these calls will lead to decisions made by the receiving broker to trust or not trust data received and further expose the process to errors.

The lack of a standardized format in which the data must be sent means data will come in all types of formats. This further complicates the data entry process. Receiving firms must interpret what certain fields mean which will be another source of data entry errors. In addition, contact information (phone #, mailing address, fax # etc.) will need to be centrally established for every firm to facilitate this process. Phone teams will need to have expertise in cost basis and transfers to facilitate necessary information sharing. This includes record keeping by the deliverer to prove that basis records were sent and for the receiver to prove that a contact attempt was made in the event all basis wasn't received.

**Serial number**

The requirement to utilize a serial number for corporate actions is very problematic because to do so the receiver would need to maintain a database of issuer actions and the relevant serial numbers and then do a compare with each lot received to determine if an adjustment is required. This would also require brokers to update their corporate action system to capture this serial number and post it to new tax lot fields which can be sent on a transfer. However, if the deliverer is accountable for sending corrected basis, what value does this serial number provide? In today's world brokers are required to update systems and produce corrected 1099s in some cases, when notified of a corporate action correction. Firms do this by checking their stock record to determine which accounts held the security on the date when the correction occurred. Only the broker that held the position on the date of the action has the information necessary to correctly adjust the basis. If the receiver had to make corrections to basis based on a correction that occurred when the position was not even on the broker's stock record, this creates system issues and risk of errors. FIF believes that the intent of the serial number requirement is to accommodate a provision in the proposed regulations that exempts certain parties (such as transfer agents) from having to adjust basis for corporate actions. FIF believes that this is an unfair exemption that places a burden on the industry in the event a serial number is required to be tracked.

**Corrections to transferred securities**

We cannot underestimate the impact on CBRS to support corrections. In today's world, a CBRS record always coincides with an asset transfer record in ACATS. In the new world, CBRS records will be transferring corrected basis information without the transfer of a security (actual security already transferred sometime previously). This topic creates many implementation questions which will not be resolved in time to meet the 2011 effective date.

Beyond the industry coordination challenges of transferring corrected basis, each firm also has significant new work to support this. Any time corrected basis is received for any security, each firm will now have to perform a system reconciliation to see if that security had been transferred out after the correction. If so, this must send a trigger to produce and send a corrected record. This is a significant challenge that every firm will need to solve.

# Appendix II – Additional Implementation Questions

This letter has highlighted some of the most pressing issues faced by the industry focusing specifically on implementation challenges. The following questions require clarification for the industry to correctly implement the new requirements.

**Dividend Reinvestment Plans**

- For purposes of defining a DRP, since the proposed regulations provide that the stock of a successor entity or entities that result from certain corporate actions such as mergers, consolidations, split-offs, or spinoffs, is identical to the stock of the predecessor entity, does that mean that stocks not eligible for their own DRP must still be tracked as DRP-eligible in order to maintain average pricing; and, how is the broker to document and indicate that non-DRP eligible stocks are actually eligible under this exception for IRS audit trail purposes?

- The proposed regulations require that a taxpayer must notify a custodian or agent in writing of an average basis method election, but otherwise do not specify how a taxpayer must communicate a basis determination method. Is an electronic selection on a brokerage input screen sufficient for this purpose?

- Since a customer can effectively revoke an average cost election for future share purchases by simply opening another account with the broker, requiring consent from the IRS to change an election prospectively seems burdensome and not effective. Taxpayers who are wise enough to understand this gap in the election change process will be able to change elections for all their DRP securities with the opening of a single new account, while other taxpayers who are not as smart at gaming the system may choose to retain the average method despite a desire to change in order to avoid the time consuming and potentially confusing process of applying to the Commissioner for an accounting method change. The FIF requests that changing lot method selection from average cost to another method be exempted from treatment as an accounting method change and simply be treated in the same manner as other lot method elections are treated under the proposed regulations; or, in the alternative, FIF requests clear assurances that permitting the opening of new accounts, regardless of the reason why, will not give rise to a broker being culpable in any manner for a violation of the accounting change rules.

- Since the term “dividend reinvestment plan” includes both issuer administered dividend reinvestment plans and non-issuer administered dividend reinvestment plans, does the withdrawal from an issuer’s plan prevent the joining of a non-issuer’s plan in the same CUSIP?

- If a taxpayer withdraws stock from a dividend reinvestment plan, then the shares of identical stock which the taxpayer acquires after the withdrawal from the plan are not considered acquired in connection with a dividend reinvestment plan. However, the taxpayer may be holding shares of the same security not participating in the DRP already. Since these are not considered identical shares are they still eligible to begin a new participation in the same DRP as it relates to those shares?

**Reporting Issues**

- Since a single sale in an account could necessitate as many as three returns (if the sale included covered securities held more than a year, covered securities held one year or less, and uncovered securities), it is questionable the extent to which this reporting will facilitate reconciliation between the taxpayers filing and the broker's reporting. FIF requests the IRS to reconsider whether 1099B reporting in this fashion accomplishes its overall goal of matching taxpayer filings with broker filings, and consider alternative methods of reporting?

- The proposed regulations state "a broker is required to report, **on a single return of information,** the information required by paragraph (d)(2)(i) of this section including the relevant information regarding the securities sold to open the short sale and the adjusted basis for the securities acquired or delivered to close the short sale." Does this mean that a broker's system must aggregate multiple buys, executed as separate trades on a single day, and consolidate them into one transaction for 1099B reporting purposes?

**Covered – Non-covered**

- Section 1.6045-1 (a) (14) appears to apply during the transition period when certain hybrid securities might be questionable as to their character and the issuer has not issued a definitive opinion on the securities type. While giving a broker latitude in determining whether the security is covered or not is appealing, to avoid confusion clear guidance is needed on how to treat transferred securities that the transferring broker has labeled a security as not covered and the receiving broker believes it is. This could be especially problematic in those instances where two or more accounts have transferred into a consolidating third brokerage account and the two transferors treated a specific security or class of securities differently. Guidance is requested to assist the receiving broker in applying the basis rules for these securities in this situation.

## Short Sales

- If a taxpayer borrows stock to make a short sale, they may have to remit to the lender payments in lieu of the dividends distributed while maintaining the short position. These payments are deductible only if the taxpayer holds the short sale open at least 46 days (more than 1 year in the case of an extraordinary dividend) and itemizes his deductions. Under current regulations, if a taxpayer closes a short sale by the 45th day after the date of the short sale (1 year or less in the case of an extraordinary dividend), the taxpayer cannot deduct the payment in lieu of the dividend that he made to the lender. Instead, the taxpayer must increase the basis of the stock used to close the short sale by that amount. Does the application of this rule require brokers to track and attach dividends for short position basis tracking as of January 1, 2010 in the case of extraordinary dividends, and November 17, 2010 in the case of other dividends?

- With regard to the above, is it also correct to assume that if a payment in lieu is made for a liquidating distribution or nontaxable stock distribution, or if the taxpayer bought more shares equal to a stock distribution issued on the stock borrowed to cover the short position, this would be a capital expense and the broker would be required to add the payment to the cost of the stock sold short for basis reporting purposes for sales opened in 2010 and remaining open into 2011?

## End Notes

[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] Written communications to date include: FIF Comment Letter I of February 27, 2009 outlining open issues that need to be addressed as part of the implementation process; FIF Comment Letter II of April 7, 2009 specifically addressing questions in Notice 2009-17; FIF Comment Letter III to IRS on Cost Basis Implementation Timing Concerns written November 13, 2009; and November 25, 2009 - FIF Letter to Treasury, also raising concerns about the January 2011 Implementation Timing.

[3] Please note: the rules as proposed would require brokers to have begun collecting certain data in January 2010 in order to handle reporting on short sales as it has been proposed in 2011; therefore, the effective date with respect to short sales is January 1, 2010.

[4] The FIF Cost Basis Working Group includes 250 members from over 45 broker dealer, service bureau and vendor firms.

[5] Source: FIF Member and Industry estimates

[6] Source: FIF Cost Basis Working Group derived this estimate based on brokerage account statistics published by the Tower Group, and a survey of member firms' actual experience with account transfers.

[7] CBRS is an automated system that provides brokerage firms, banks and other financial organizations the ability to transfer customer cost basis information from one firm to another on any asset transferred through the Automated Customer Account Transfer Service (ACATS).