SIFMA

Securities Industry and Financial Markets Association

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Electronic Delivery

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Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (REG-101896-09)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20024

RE: Supplemental Comments on Proposed Regulations on Determining and Reporting Adjusted Tax Basis on Securities – REG – 101896-09

Dear Mr. Schaeffer:

The Securities Industry and Financial Markets Association (SIFMA)[1] is pleased to present expanded and additional comments on the proposed basis reporting regulations released on December 16, 2009 (REG – 101896-09) (the "Proposed Regulations"). This letter responds to some concerns raised at the public hearing on February 17, 2010, and raises additional issues for your consideration in finalizing the Proposed Regulations. SIFMA also renews the comments made in its letter dated February 8, 2010, and adds supplemental information or modifications on certain issues as contained in this letter. A copy of the February 8 letter is enclosed for your convenience. SIFMA is eager to assist the Internal Revenue Service (the "IRS") and the Department of Treasury in developing clear and objective rules for implementing basis reporting to ensure that all participants know their roles and obligations and that adjusted basis and holding period information will be consistently reported across the securities industry. SIFMA sincerely appreciates your consideration of these collective comments on the Proposed Regulations.

Transition Relief for Transfer Reporting

As stated in our letter dated February 8 and at the public hearing on February 17, SIFMA requests that the onset of transfer reporting under new section 6045A of the Internal Revenue Code (the "Code") be delayed one year until 2012. Since 2006 when basis reporting was initially proposed, SIFMA has emphasized that brokers would need a minimum of 18 months after the final regulations are published to

[1] SIFMA brings together the shared interests of securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

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develop the systems and procedures necessary to accurately report basis information on Forms 1099-B. This projected time frame was conditional upon the adoption of certain simplifications in the reporting rules. Many of these simplifications were included in the basis reporting statute as enacted in October 2008. However, the Proposed Regulations contain some unexpected requirements that, if not simplified or eliminated, greatly complicate information reporting and collectively make the January 1, 2011 effective date for basis tracking on stocks quite difficult, if not impossible, to meet. In particular, brokers did not expect to be required to track basis and holding period on inherited or gifted securities or to have to determine the basis of gifted securities at the time sold under the complex income tax rules that are currently applicable. Brokers were also optimistic that Treasury and IRS would exclude small transactions from wash sale accounting (e.g., sales of fractional shares and acquisitions of new shares by reinvesting dividends). Simply put, SIFMA believes that the aggregate development effort required to meet all the proposed requirements is too great to accomplish in the time remaining before January 1, 2011, and this creates a significant risk of inaccurate information returns because brokers will have insufficient time to develop and thoroughly test all the component systems and information flows.

Facing this reality, the members of SIFMA undertook to identify what provisions of the Proposed Regulations could be reasonably deferred without materially undermining the overall objective of starting basis reporting in 2011. SIFMA has concluded that it is fair to expect brokers to be able to develop the systems and procedures necessary to track, adjust basis and report on transactions within their control, that is, on positions in stock acquired and sold through the same broker. However, transfer reporting requires cooperation among unrelated entities, including applicable persons who are not brokers, and the development of a centralized industry utility with a standardized format and using an electronic delivery mechanism. Since transfer reporting is a function that depends largely on others and is severable from a broker's core tax lot accounting systems, SIFMA believes that a delay in reporting on transferred securities would provide the needed relief and give brokers a better chance of meeting the January 1, 2011 effective date.

SIFMA believes that the proposed delay in transfer reporting will not significantly impair the overall objective of requiring that tax basis and holding period information be reported by brokers on covered sales or redemptions of stock that occur in 2011. Since the first phase of basis reporting covers only stock (other than stock in a regulated investment company or a dividend reinvestment plan) acquired after 2010, sales of stock that are both acquired and transferred by an "applicable person" in 2011 are expected to be minimal in 2011. Furthermore, available industry statistics indicate that in 2009 less than 3 percent of existing brokerage accounts were transferred to a different firm through the Automated Customer Account Transfer System ("ACATS"), which is operated by a subsidiary of the Depository Trust and Clearing Corporation ("DTCC") and is the primary mechanism used to transfer securities between brokers.[2] In response to concerns raised by Treasury at the public hearing that taxpayers might transfer securities in 2011 solely to avoid basis reporting if the requested delay is granted, SIFMA notes that accounts are not readily transferable and that there are paperwork requirements, fees and processing time that act as a hurdle to a transfer of an account. In any event, the taxpayer remains responsible for reporting accurate basis information on his/her federal income tax return regardless of whether a transfer statement is provided to a transferee broker. While we sincerely believe that transfers to evade basis reporting will be rare, the Code does contain both civil and criminal penalties for taxpayers who act intentionally evade

[2] The statistics were derived from Broker Account Data at Tower Securities and ACAT data at DTCC.

federal income tax. In addition, Code provisions that punish those who aid and abet tax evasion should be an effective deterrent to brokers who might otherwise try to entice taxpayers to transfer their accounts from another broker solely to avoid basis reporting.

Finally, SIFMA has found ample legal precedents and examples to support the view that Treasury has authority to grant the requested delay in the effective date for transfer reporting. These authorities are described in the enclosed letter to Congressional leaders dated March 24, 2010.

For these reasons, SIFMA urges Treasury and IRS to act quickly to publish a notice or other official guidance to delay for one year the effective date for transfer reporting under Code section 6045A. Only quick action will have the desired effect on the development of basis reporting systems and procedures.

Covered or Non-covered Securities

SIFMA's concern about the effective date for reporting basis in transferred securities is also prompted by a number of unsettled issues affecting what is a covered security. This is a key concept since it also determines whether or not basis and holding period information are required to be reported to a transferee broker. Furthermore, the "applicable person" that has "custody" of the security when it is transferred to a new taxpayer may or may not be a broker. It is also possible that the person in the best position to know the basis information resulting from an acquisition of stock is not the custodian of the securities (e.g., a stock plan administrator that is a mere record keeper or a fiduciary that is not also a professional custodian of securities). Such persons are generally not familiar with the information reporting rules for sales of securities. Each participant in an acquisition or transfer needs to know what are its role and responsibilities, if any. Brokers will not be in a position to know the basis or holding period information in situations where the terms of the acquisition are not known to them. For these reasons, SIFMA requests that the situations described below be addressed explicitly in the Proposed Regulations to obtain such clarity.

Proposed Regulation section 1.6045-1(a)(15) provides that the term "covered security" means any specified security "acquired through a sale transaction in an account" on or after the applicable effective date and any specified security "transferred to an account in a non-sale transaction, provided that the broker or other custodian of the account receives a transfer statement…reporting the security as a covered security." It appears from this definition that a covered security is one that is "purchased" by the taxpayer through an account on or after the applicable effective date. It would be helpful if the Proposed Regulations were amended to clarify, by way of explicit examples, whether securities acquired in the following types of sale transactions are covered securities:

- A purchase of stock by an employee upon the exercise of a stock option that was granted pursuant to a qualified or non-qualified stock option plan adopted by the employer.[3]
- A purchase of stock by the exercise of an exchange listed or OTC call option in the account.

[3]Stock acquired upon the exercise of a non-qualified stock option would generally have a tax basis equal to the fair market value of the stock on the exercise date. The tax basis in stock acquired upon the exercise of an incentive stock option can vary depending on whether the new stock was acquired with old stock (a stock swap) and whether there has been a disqualifying disposition. See Regulations under Code section 422.

- The exercise of rights distributed by an issuer to purchase additional shares of its stock.[4]
- A purchase of stock by exercising a put option that results in the assignment of stock away from the option writer.
- A purchase of stock through an executing broker in a receive vs. payment (RVP) transaction where the receiving broker obtains custody of the purchased security for the benefit of the taxpayer.

In addition, SIFMA wishes to obtain clarification on whether or not the following non-sale transactions are covered:

- Restricted stock awarded by an employer to an employee as equity compensation where the stock is subject to substantial risk of forfeiture.
- A distribution by the issuer of additional shares of its common stock (generally a non-taxable event) or its preferred stock (a taxable event) to its shareholders.
- A distribution of securities from an individual retirement account or plan (IRA) to the IRA owner or an heir due to the death of the IRA owner.[5]
- Stock acquired by conversion of a bond or debenture into stock under the terms of a convertible debt instrument.
- Common stock acquired by conversion of preferred stock into common stock under the terms of the convertible preferred stock.

<u>Transfers for Exempt Recipients</u>

Proposed Regulation section 1.6045A-1(b)(2) governing transfers of non-covered or excepted securities requires that a transfer statement for a non-covered or excepted security be delivered by the applicable person to the transferee broker and that the statement identify the transferred security as not covered. No other information with respect to the transferred security is required. Upon further consideration, SIFMA believes that to require a transfer statement in all cases will produce an enormous amount of unnecessary transfer reports, including transfers between financial institutions. In addition, it would require an institutional business that serves only accounts that can be identified as exempt recipients under Regulation section 1.6045-1(c)(3) to build a transfer reporting system solely for the purpose of informing the transferee broker that the transferred security is not covered. To reduce or eliminate these burdens,

[4] We note that under SEC rules, rights distributed by foreign corporations on ordinary or preference shares cannot be issued to holders of American Depository Receipts (ADRs) that represent such shares. In practice, such rights are sold prior to their issuance to ADR holders, and the cash proceeds are instead distributed to the ADR holders. Since this cash payment results from the sale of an option to buy additional shares, SIFMA believes that the no basis information is required to be reported for distributions made prior to January 1, 2013 (the proposed effective date for reporting on options).

[5] SIFMA believes it is clear that there is no requirement to track basis or holding period information on a security while it is part of an IRA, since an IRA is an exempt recipient. Furthermore, the basis and holding period in distributed securities is not derived from the basis of the securities in the hands of an IRA. Instead, the adjusted tax basis of a distributed security is its fair market value as of the date of distribution and the holding period begins on the date of distribution.

SIFMA respectfully requests that an applicable person not be required to furnish a transfer statement to a broker when the originating account has been identified by the applicable person as an exempt recipient.

Transfers of Inherited Securities

In the case of a transfer of a security from a decedent or a decedent's estate, Proposed Regulation section 1.6045A-1(b)(3)(i) states that a transfer statement must indicate that the security is inherited, report the date of death as the original acquisition date and report adjusted basis in accordance with instructions or valuations provided by an authorized representative of the estate. The Proposed Regulation further requires that the applicable person that effects the transfer is required to solicit this information once, and not more than once, for each transferred security. If complete instructions are not received by the applicable person before the transfer statement is prepared, the transfer statement is required to state that the security is inherited but is otherwise a non-covered security.

SIFMA believes that the requirement for the applicable person to solicit the basis information from the estate's representative is not necessary and should be dropped. Instead, an applicable person should be permitted to presume that in the absence of any contrary instructions from the estate that the basis in the inherited security is equal to the fair market value of the security on the date of death, and report that value on the transfer statement. If after 2010, the tax law for inherited property returns to that in place in 2001, the heirs would be entitled to a stepped-up basis (to fair market value) in inherited securities that have appreciated, the adoption of this presumption would greatly simplify the reporting process and would generally mean that the original transfer statement would be correct and the applicable person would not have to issue a corrected transfer statement based on late information.

Transfers of Gifted Securities

In the case of a transfer that effects a change in ownership of the security (other than transfers from a decedent or decedent's estate), Proposed Regulation section 1.6045A-1(b)(4) requires that a transfer statement must indicate that the security is a gift and must report the date of the gift (if known), and the fair market value ("FMV basis") of the gift on that date (if known or readily ascertainable). For purposes of this reporting requirement, the adjusted basis and original acquisition date are the adjusted basis (the "carryover basis") and original acquisition date of the security in the hands of the donor.

When the donee later sells the gifted security, the broker is required by Proposed Regulation section 1.6045-1(d)(6)(ii)(B)(2) to apply the relevant tax rule for property acquired by gift to determine the basis of the security at the time sold. This would require the broker to track and separately adjust, when necessary, both the carryover basis and the FMV basis and determine which basis applies, depending on whether there was a resulting gain or loss on the sale. We appreciate the special rule in the Proposed Regulation that excuses the broker from taking into account the gift tax paid. However, the substantive rules for determining the tax basis of gifted securities are very difficult to incorporate into brokers' existing tax lot accounting systems. This difficulty is further compounded if the transfer is part-gift, part-sale. To simplify the reporting and the basis determination on gifted securities in preparation for the January 1, 2011 effective date, SIFMA requests that the FMV basis and gift date information not be required to be reported on a transfer statement or separately tracked and adjusted by a broker for use in determining the basis of securities sold. Rather, for information reporting purposes, the broker should be able to use the carryover basis and tack the donor’s holding period in reporting the sale of gifted securities.

Transfers of Borrowed Securities

As stated in our prior comments, the acts of lending and returning a security under a securities lending agreement that meets the requirements of Code section 1058 are transfers of securities that SIFMA believes should be excluded from the new transfer reporting requirement of Code section 6045A. Borrowed securities are typically used to settle a short sale, to prevent a failure to deliver or to on-lend to another party for such purposes. Since the ultimate borrower generally uses the transferred securities immediately in a sale to a third party, the third party acquires basis in the purchased securities equal to the purchase price of the securities. The purchaser does not derive his basis in the purchased securities from the lender’s basis in the securities and therefore no transfer statement should be required when the securities are loaned to the borrower and used in a sale transaction. Since the borrower himself does not own the transferred securities, the borrower does not need a transfer statement. Furthermore, the lender of the securities continues to maintain his tax basis in the securities on loan and to extend his holding period while the securities are on loan. The lender’s broker necessarily continues to track the lender’s basis and holding period in the securities that are on loan and therefore does not need a transfer statement when the identical securities are returned to the lender. Given these realities, the Proposed Regulations should except from the transfer reporting requirement any transfer of securities pursuant to a securities lending agreement.

The Proposed Regulations at section 1.6045A-1(b)(5) address a special situation where securities are borrowed by a short seller to cover or close out an open short sale. The Proposed Regulation would require that the applicable person that transfers the security to the short seller indicate that the transferred security is borrowed and that the adjusted basis of the security is zero. The transfer statement must also instruct the broker receiving custody to provide the applicable person effecting the transfer with information about any short position potentially being closed by the transfer or other disposition of the borrowed securities. SIFMA understands that this Proposed Regulation is intended to support the requirement that a broker receiving the borrowed securities not issue a Form 1099-B at the time the short sale is covered because under Code section 1233 this event does not close the short sale for tax purposes. See Proposed Regulation section 1.6045-1(c)(3)(xi)(C) and (c)(4), Example 11. The Proposed Regulation and Example 11 appear to assume that the taxpayer maintains a custody account with both the transferor of the borrowed securities and the receiving broker. In practice, this is a rare occurrence. Most likely, the receiving broker would borrow the securities from another broker or custodian that does not maintain an account in the name of the short seller. SIFMA believes that the proposed transfer statement should not be required where the applicable person transfers securities to the receiving broker from a person other than the taxpayer that sold the securities short.

In any event, it is possible that the taxpayer’s account is transferred to another custodian before the short sale is closed for tax purposes. Only in this instance would we expect that the transferor broker would need to provide a transfer statement to the receiving broker respecting the short sale that remains open for tax purposes. SIFMA recommends that the Proposed Regulations and Example 11 be amended accordingly.

Publication of Tax Information on Organizational Actions

New Code section 6045B requires that an issuer (or its successor) file a return with the IRS and furnish nominees and certificate holders with a written statement regarding an "organizational action" that affects tax basis in a covered security. This return or statement must:

- Describe any action which affects the tax basis in a security
- Set forth the resulting quantitative effect of the action on tax basis
- Identify the organizational action by a sequential identification number
- Provide issuer contact information

The IRS filing is due the earlier of the 45th day after the organizational action occurs or January 15 after the end of the calendar year. However, the written statements are due January 15 after the end of the calendar year.

Proposed Regulation sections 1.6045B-1(a)(3) and (b)(4) excuses the issuer from the return filing and written statement requirements if by the applicable due date, the issuer posts "the required information in a readily accessible format in an area of its primary public website dedicated to this purpose and keeps the return accessible to the public." SIFMA supports this "publication" alternative as a very useful way to reduce the burdens of tax administration and the concept of providing a place where all brokers can access the required information without waiting for a written statement to be received in the mail. We also note that in some cases there may be multiple "issuers" or "distributing corporations" that should have responsibility for publishing tax information respecting a single transaction. For example, in a taxable spinoff, both the corporation that distributes shares in the spun-off corporation and the spun-off corporation itself should be required to maintain the tax information on their respective web sites.

In its prior comments and at the public hearing, SIFMA presented its views on how an issuer should publicize tax information on organizational actions that affect the determination of tax basis in a security. Since there was confusion at the public hearing on the particulars of SIFMA's proposal, we wish to re-state and clarify the proposal at this time. While SIFMA would prefer that the IRS agree to be the collection point for this tax information and to maintain a centralized website that could be accessed by all brokers, we understand that the IRS is reluctant to assume such responsibilities and has suggested that the securities industry establish its own centralized facility for such information. In light of the IRS position, SIFMA recommends that the "publication" alternative be expanded to require broader and more proactive distribution by the issuer of the tax information relevant to an organizational action. Not only should the issuer be required to post the information on its primary web site, it should also be required to take the following actions:

- Furnish issuer statements to all clearing organizations where the affected securities are eligible for clearing (e.g., The Depository Trust and Clearing Corporation, Euroclear, Clearstream). These clearing organizations would, in turn, distribute this tax information, unchanged, to their participants in the same manner as they currently distribute other tax information to their participants in the ordinary course of their business.
- Furnish issuer statements to vendors of tax information upon request

- Furnish issuer statements through its transfer agent, exchange agent or information agent to nominees or tax vendors upon request, even if the requestor does not have an "account" on the books of the agent.

SIFMA believes that all these multiple avenues of distributing the required tax information are necessary to ensure that all brokers have ready access to this information and use it in a consistent manner.

SIFMA also seeks clarification on the due date for issuers to publicize tax information on basis affecting events. Proposed Regulation section 1.6045B-1(b)(4) (reporting to nominees and certificate holders) does not contain an explicit due date but refers to section 1.6045B-1(a)(3) (reporting to IRS) for the public reporting requirement. SIFMA requests that the IRS confirm that the due date for publicizing basis affecting information for use by nominees and other brokers is the earlier of 45 days from the date of the organization action or January 15 of the following year. This deadline is needed because brokers will not be able to collect, understand and process tax information on all the basis affecting events that occurred during the calendar year at the same time in January. Rather, brokers need this tax information as soon as it is available in order to ensure that the basis adjustments are properly made and to deliver the resulting information in monthly statements to their customers.

<u>Redemptions of Stock and Corporate Reorganizations</u>

Proposed Regulation section 1.6045-1(a)(9) defines the term "sale" for purposes of information reporting on sales and redemptions of securities. It modifies the current law definition of the term to clarify that broker reporting is required only if the disposition is for "cash." Specifically, the Proposed Regulation states that "[t]he term 'sale' means any disposition **for cash** of securities, commodities, regulated futures contracts or forward contracts, and includes redemptions of stock, retirements of indebtedness, and entering into short sales <u>**when these actions are conducted for cash"** (emphasis added)</u>. The proposed modification to the definition of sale appears to be intended to make clear that gross proceeds from the disposition of stock must be reported on Form 1099-B only where the consideration paid is cash. Where the consideration paid for stock consists of property and minimal cash, the IRS has concluded under present law that no reporting is required under section 6045. See Ltr. Rul. 8617063 (January 28, 1986).[6]

<u>Self-tenders.</u> Where a corporation offers to purchase its own stock (commonly known as a "self tender") in a non-pro rata distribution, the redemption is considered an exchange in payment for stock only if the transaction meets any of the following tests in Code section 302(b): (1) the shareholder's interest in the corporation is completely terminated, (2) the transaction is substantially disproportionate to that particular shareholder, (3) the transaction is not "essentially equivalent to a dividend," or (4) the redeemed stock is not held by a corporation and the redemption is in partial liquidation of the distributing corporation. If the transaction meets one of these conditions, then the transaction is treated as an exchange taxable as a sale. On the other hand, if the transaction does not meet any of these conditions, it is treated as a distribution with respect to stock under Code section 301 and is taxed as ordinary dividend

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[6] For a contrary result, see PLR 8916997 (January 11, 1989). There the IRS concluded that a broker must report as gross proceeds the total cash plus the fair market value of securities paid to public debt holders in the consummation of a Plan of Reorganization under Chapter 11 of the Bankruptcy Act. See also FSA 1993-1217-3 for a discussion of the issue of whether only cash is reportable on Form 1099-B.

income to the extent of corporate earnings and profits. Whether the redemption is treated as an exchange or a dividend depends on each shareholder's particular facts and circumstances. Thus, the determination of the character of any gain on the transaction cannot be determined by the issuer at the corporate level.

These tax principles apply where a corporation offers to distribute cash for stock, debt for stock, or a combination of debt and cash for stock, provided that the distribution is not pro-rata with respect to all shareholders. In several private letter rulings, the IRS concluded that redemptions pursuant to a self-tender are "required" to be reported as dividends under Code section 6042(a). Nevertheless, the IRS allowed the issuer to report such redemptions as gross proceeds on Form 1099-B in satisfaction of the section 6042(a) reporting requirement. Ltr. Ruls. 8617063 (January 28, 1986) (Tender offer of notes for stock; minimal cash paid in lieu of fractional notes), 8850004 (August 31, 1988) (Tender offer of notes and cash for stock), 9017047 (January 30, 1990) (Tender offer of cash only, debentures only, debentures and cash, or debentures, stock and cash for Class C stock at the shareholder's option), and 8617068 (January 28, 1986) (Tender offer of a package of debt securities for common stock). The same conclusion was reached when the tender offer was for cash only. See Ltd. Rul. 8920007 (February 2, 1989) (Tender of cash for common stock), In each of these rulings, the issuer represented that it was unable to determine at the corporate level whether particular shareholders are entitled to exchange treatment under Code section 302, because that determination depends to each shareholder's particular facts and circumstances. However, the issuer believed that most shareholders would qualify for exchange treatment. The IRS acknowledged that an issuer does not ordinarily possess the shareholder specific facts and circumstances that are necessary to determine the tax character of a redemption as to each shareholder. To accommodate this inherent difficultly, the IRS allowed the issuers to report these transactions as fully taxable exchanges on Form 1099-B, instead of as dividends on Form 1099-DIV, provided that the Form 1099 was accompanied by a written statement that explains the possible tax consequences of the transaction. Many brokers have also reported non-pro rata redemptions on Forms 1099-B in accordance with this position.

Corporate Reorganizations. Similarly, this reporting issue arises in connection with corporate reorganizations that are not wholly tax-free transactions. If shareholders in an otherwise tax-free reorganization receive cash or "other property" (i.e., boot) in addition to qualified stock or securities, the recognized gain is taxed as a capital gain,, unless under Code section 356(a)(2) the exchange has "the effect of the distribution of a dividend." The principles of Code section 302(b) have been applied to make this determination. The amount subject to tax is the lesser of the value of the boot or the actual amount of any gain realized. If the exchange has the effect of a dividend distribution, the taxable amount is characterized as a dividend to the extent of the accumulated earnings and profits. Any remaining taxable amount is recognized as gain from the exchange of the "old" stock. On the other hand, if the actual gain realized exceeds the value of the boot, the unrecognized gain is deferred until the disposition of the "new" stock or securities. If a loss is realized on the exchange, the loss may not be recognized for tax purposes. Under Code section 358(a)(2), the tax basis in any boot property received in a corporate reorganization is its fair market value on the date of the exchange. The basis of property received without the recognition of gain or loss is the same as the property exchanged, and is adjusted as follows under section 358(a)(1): (a) decreased by the fair market value of any boot property plus any money received and (b) increased by the amount of any gain recognized (including any amount treated as a dividend).

In light of the new basis reporting requirements, brokers need to know (1) whether the exchange is reportable on any Form 1099, (2) if reportable, whether the exchange is reportable as dividends on Form 1099-DIV or as a sale on Form 1099-B, (3) if reportable on Form 1099-B, what amounts to report in each box (gross proceeds, adjusted basis, gain/loss), and (4) what is the adjusted basis of new securities (qualified securities and boot property) received in the exchange. If an exchange is reportable on Form 1099-B, brokers need to know whether to report as gross proceeds, (a) only the cash amount received, (b) the aggregate value of the boot property and cash received, (c) the gain realized, or (d) the total value of all the consideration paid on the exchange (including the value of securities received tax-free). The determination as to what amounts should be included in gross proceeds may affect the determination of what amounts should be reported in other boxes on the draft Form 1099-B for 2011. Should the adjusted basis for the securities sold be the adjusted basis in "all" of the securities exchanged in the reorganization or just the portion allocable to the securities exchanged for taxable consideration? Should any gain reported be the amount of gain realized or the gain recognized? Should any loss realized be reported, even though it is not recognized for tax purposes? Brokers need to know how to report gross proceeds from an exchange, whether the securities exchanged are covered or non-covered securities. It would be preferable that the same methodology be applied in both situations to avoid taxpayer confusion.

Presumption of Exchange Treatment. Brokers do not possess the personal information necessary to determine whether section 302 or section 301 applies in a shareholder's particular circumstances, and it would be virtually impossible to collect this information given the frequency and complexity of corporate redemptions and reorganizations and the present tax rules. In any event, in most cases involving publicly traded stock, the redemption or exchange would not be essentially equivalent to a dividend based on existing case law. To achieve consistency in reporting and simplification in the implementation of basis reporting, SIFMA recommends that in the case of a self-tender or an exchange of stock that is taxable under either section 301 or 302, the transaction be presumed to be a payment in exchange for stock for tax purposes and that a broker be permitted to report the transaction on a Form 1099-B and to adjust basis as if no dividend income were paid.

Covered Status of Securities Received. The final regulations should provide guidance on which securities received in an exchange are covered or non-covered securities when the stock surrendered is not covered. SIFMA recommends that (a) any securities received tax-free be classified as non-covered securities and (b) any securities received in a fully taxable exchange or as boot in an otherwise tax-free exchange be classified as covered securities if the exchange occurs after the effective date for basis reporting. Securities received tax-free would have a substituted basis (adjusted for any boot) and a tacked holding period and thus such information is derived from the securities surrendered in the exchange. However, where the securities surrendered are not covered, a broker might not have the basis or holding period information needed to establish the adjusted basis and holding period in the securities received. On the other hand, taxable securities received in the exchange would acquire an original basis equal to their fair market value on the effective date of the exchange and a new holding period beginning on that date.

Determining Holding Period After a Wash Sale

Under Proposed Regulation section 1.6045A-1(b)(vii), a transfer statement must show the original acquisition date of the security and the date for computing whether any gain or loss with respect to the security is long-term or short-term upon the subsequent sale. Proposed Regulation section 1.6045-1(d)(7)(ii) states that when reporting the sale of a security whose acquisition triggers a wash sale, a broker must apply section 1091 when determining whether any gain or loss on the sale is long-term or short term within the meaning of Code section 1222. Under Code section 1223(3), the holding period in the replacement stock includes the holding period in the securities sold at a loss in a wash sale.

In implementing the transfer reporting rules, most brokers expect to use the original acquisition date of the shares sold in a wash sale as the date for computing whether any gain or loss on the replacement shares is short-term or long-term. This date can be copied and associated with the replacement shares at the time the basis in the replacement shares is adjusted for the loss disallowed in the wash sale. In most cases, the original acquisition date of the shares sold in the wash sale can be used by the broker to accurately determine the holding period of the replacement shares. However, if the replacement shares are purchased within the 30 day period AFTER the date the wash sale occurs, the holding period in the replacement shares does not technically include the days between the wash sale and the purchase of the replacement shares. So, it would be more accurate to use the actual number of days in the holding period, rather than the original acquisition date, of the shares sold in the wash sale. SIFMA requests clarification on whether or not the original acquisition date of the shares sold in the wash sale needs to be adjusted for this gap period. We believe it would be simpler to implement the wash sale rules if the final regulations clarified that brokers are not required to adjust the original acquisition date of the shares sold in this situation. Otherwise, the content of the transfer statement would need to be changed to the number of days to be tacked on the holding period in the replacement shares and thus would likely be confusing and error prone.

<u>High Frequency Traders</u>

Treasury and IRS have requested comments on the treatment of high frequency traders, including specifics about the burden that basis reporting may impose, and how brokers can identify customers that have made valid and timely mark-to-market elections under section 475(e) or (f) and which transactions by these persons are subject to the provisions of section 475. At present, the Proposed Regulations contain no provisions that would except high frequency traders from basis reporting. Rather, Proposed Regulation section 1.6045-1(d)(7)(iii) provides that a broker “must” determine whether any gain or loss on the sale of a security is long-term or short-term without regard to the mark-to-market (“MTM”) method of accounting.

SIFMA believes that the requirement to treat high frequency traders the same as all other non-exempt recipients for purposes of basis reporting will place unnecessary stress upon the running of tax lot accounting systems due to the large volumes of transactions conducted by such traders. This is likely to occur in large part because of the requirement to account for wash sales by monitoring for acquisitions that occur both before and after a sale at a loss. It also complicates and makes more time consuming the necessary process of reconciling transaction information with basis reporting information. To reduce these burdens, SIFMA recommends that (1) brokers be allowed, but not required, to identify non-exempt recipients that have made valid MTM elections for positions in an account, and (2) if an account is so identified, brokers be allowed to report basis and holding period information on securities sold without regard to the wash sale rules. The identification could be based upon an oral or written representation made to the broker by the high frequency trader. Implementation would be simpler if this identification could be made at the account level and would therefore apply to all positions in the account. This would mean that the customer could not include in the account any positions that were not subject to the MTM election. Such positions would need to be maintained in a separate account. If the broker chooses to take the MTM election into account, the broker could be required to flag the relevant Form 1099-B (by use of a check-box or other MTM indicator on the Form). This flag would notify the IRS that the wash sale rules have not been taken into account in determining the gain/loss on the sale and would enable the IRS to cross-check against the taxpayer's federal income tax return the validity of the MTM election. SIFMA seeks this alternative for reporting on qualified high frequency traders as a practical means of reducing reporting burdens without compromising the government's reporting objectives.

Backup Withholding on Short Sales

Proposed Regulation section 31.3406(b)(3)-2(b)(4) would require brokers to perform backup withholding, if required, at the time a short sale is closed, rather than at the time the short sale is opened, apparently to conform to the proposed change in the time for reporting the gross proceeds from a short sale of securities. However, SIFMA and others have observed that since short sellers are permitted to withdraw excess margin from a short sale account, a broker may have insufficient cash from which to satisfy the backup withholding obligation (28 percent of the gross proceeds) at the time the short sale is closed. In discussing this issue at length, the Information Reporting Program Advisory Committee ("IRPAC") at page IV-32 of its comment letter dated February 26, 2010 suggests that the IRS work with SIFMA to devise a workable solution to this problem.

Brokers prefer to perform backup withholding on short sale proceeds at the time the short sale is opened and based on the tax status of the account (missing Form W-9 or currently effective B Notice) at that time. SIFMA recommends that brokers be required to deposit such backup withholding in the time and manner set forth in the existing regulations and to report the liability on the Form 945 for the year in which the short sale is opened. The tax withheld should not be held in escrow until the time the short sale is closed. The amount of the backup withholding would be reported to the IRS and the non-exempt customer on a Form 1099-B for the year in which the short sale is opened. If the short sale is closed in the same calendar year in which the backup withholding was imposed, the Form 1099-B could include both the gross proceeds and basis information for the securities sold short. However, if the short sale remains open over the end of the calendar year, the Form 1099-B for the year in which the short sale is opened would show only the date of the short sale and the amount of the backup withholding. A second Form 1099-B (without any backup withholding) would be filed in the later year in which the short sale is closed. The second Form 1099-B would show the amount of the gross proceeds and the adjusted tax basis of the securities sold. This filing process would mean that the taxpayer will receive a credit for the backup withholding in the tax year in which it is actually withheld, even though it may be in a year before the gain/loss on the short sale is recognized for tax purposes. We believe that this is an acceptable timing difference because backup withholding is not imposed on the actual amount of gain realized on a sale transaction, and is in reality merely a deposit against a taxpayer's actual federal tax liability which is undetermined at the time the short sale is opened.

Repeal of the "Eyeball" Test for Corporations

Proposed Regulation section 1.6045-1(c)(1)(C) provides that after 2011 a broker must not treat a domestic or foreign corporation as an exempt recipient with respect to sales of covered securities based on the indicators described in Regulation section 1.6049-4(c)(1)(ii)(A). The Proposed Regulation effectively repeals the "eyeball" test presently being used to identify corporations as exempt recipients. The repeal was considered necessary to ensure compliance with the new statutory requirement in Code section

6045(g)(4) that brokers report on sales of securities by corporations taxable under Subchapter S ("Subchapter S Corporation"), effective January 1, 2012.

SIFMA appreciates that brokers cannot reliably distinguish "domestic" corporations taxable under Subchapter C (exempt recipients) from corporations taxable under Subchapter S (non-exempt recipients) based solely upon an account name or a corporate resolution. However, SIFMA believes that the Proposed Regulation is overly broad in that it would preclude reliance on certain indicators of exempt corporate status that should continue to be reliable. In particular, Regulation section 1.6049-4(c)(1)(ii)(A)(1) allows a broker to treat an account as an exempt corporation if the account title contains the term "insurance company, indemnity company, reinsurance company or assurance company", whether domestic or foreign. Since under Code section 1361(b)(2)(B) a domestic insurance company cannot become a Subchapter S corporation, brokers should be able to continue to rely on an account name to treat an insurance company as an exempt recipient. In addition, this subparagraph permits a broker to rely on an account name to identify "per se" foreign corporations, as listed in Regulation section 301.701-2(b)(8)(i), as exempt from information reporting on Form 1099-B. Since a foreign corporation, by definition, cannot elect to be taxed as a Subchapter S corporation, brokers should be able to continue to apply the eyeball test for per se foreign corporations.

In addition, customers that provide a Form 8832 signed on or after July 20, 2004 evidencing that an "eligible" entity has elected to be classified as an association taxable as a corporation should continue to be treated as corporations exempt from gross proceeds and basis reporting. Beginning July 24, 1004, Subchapter S corporations are not eligible entities that can file a Form 8832. (See IRS instructions to Form 8832 and Regulation section 301.7701-3(c)(1)(v)(C).) For this reason, a broker should be able to safely rely on copies of Forms 8832 to identify a corporation as an exempt recipient and not as a Subchapter S corporation.

Accordingly, SIFMA requests that the Proposed Regulation be amended to enable brokers to continue to identify exempt foreign corporations and insurance companies based on the account name and check-the-box corporations as corporations exempt from gross proceeds reporting.

<u>Accounts of Foreign Persons</u>

Proposed Regulation section 1.6045-1(d)(2)(iii) clarifies that a broker is not required to report adjusted basis or whether any gain or loss on a sale is long-term or short-term if the securities that are excepted from "all" reporting under section 6045 at the time of their acquisition, even if the status of the account holder subsequently changes (e.g., an account holder that is a tax-exempt organization at the time the security is acquired subsequently loses its tax-exempt status). Thus, if at the time the securities are acquired, the customer is exempt from information reporting, then the securities are permanently treated as non-covered securities for which no basis reporting is required. This exception applies explicitly to accounts that are identified as exempt recipients under Proposed Regulation section 1.6045-1(c)(3). However, the Proposed Regulation lacks an explicit exception from reporting adjusted basis and holding period for accounts that are exempt foreign persons (but not exempt recipients) described in Regulation section 1.6045-1(g). Exempt foreign persons include documented foreign beneficial owners and presumed foreign persons. Since such foreign persons are exempt from gross proceeds reporting, they should also be exempt from reporting on adjusted basis and holding period information. Accordingly, we recommend that the Proposed Regulation be amended to except accounts that are identified as exempt foreign persons under section 1.6045-1(g).

Definition of "Broker"

As noted in our prior comments, the Proposed Regulations expand the definition of "broker" to include a non-U.S. payor or a non-U.S. middleman that has entered into a qualified intermediary ("QI") agreement or a similar agreement with the IRS. This modification would require that non-US controlled QIs and withholding foreign flow-through entities file Forms 1099-B on gross proceeds from sales of securities, including tax and basis holding period information for the first time. Since the publication of the Proposed Regulations, the Foreign Account Tax Compliance provisions of the Hiring Incentives to Restore Employment Act ("FATCA") have been enacted. Section 1471 of FATCA would require a foreign financial institution ("FFI") to file annual returns on U.S. accounts that show the identity of the U.S. account holders or substantial U.S. owners of a foreign entity, the account balance or value and potentially the gross receipts and gross withdrawals from the account. Alternatively, the FFI may file reports on Form 1099 in the same manner as a U.S. payor or a U.S. middleman. In passing FATCA, Congress recognized that requiring FFIs to file Forms 1099 in the same manner as U.S. payors or U.S. middlemen might be too burdensome for first time filers and thus did not mandate such information reporting for all FFIs. Since the Proposed Regulations are in conflict with FATCA on this reporting requirement, the Proposed Regulations need to be modified.

SIFMA believes that to make the Form 1099 reporting alternative more attractive to non-U.S. controlled FFIs, a simplified Form 1099 reporting method needs to be made available. This simplified method should require FFIs to report on Form 1099 only cash amounts of income or gross proceeds paid to U.S. accounts. Among other things, it should not require an FFI who is also a broker to report basis or holding period information on Form 1099-B. The cost of implementing basis reporting, given all of its complexities and the open issues currently present, as well as the lead time necessary to build a basis reporting system from scratch, even if using an outside vendor, makes such reporting prohibitive to an FFI. Limiting the reporting requirement to gross proceeds would relieve much of the burden while still providing the IRS with adequate information for use in auditing the U.S. taxpayers.

Draft Form 1099-B for 2011

Disallowed Losses. We note that the draft Form 1099-B for 2011, as published on December 16, 2009, includes a new box 5 entitled "Wash sale loss disallowed." Also, a new box 7 entitled "Reported gain or loss" has been added. While the IRS has not yet published draft instructions to this form, members of SIFMA are concerned that the presence of these two boxes may result in duplicative or unnecessary reporting. It appears that brokers will be expected to quantify and report in box 6 the amount of any loss that is disallowed under the information reporting rules for wash sales. We also understand that the amount of any disallowed loss is required to be added to the tax basis of identical securities acquired during the relevant 61-day period. Thus, the reportable amount also represents a basis adjustment to the acquired securities. The question remains whether the amount of the disallowed loss should be included or excluded in reporting the total gain or loss on the sale in box 7. Brokers need clear guidance on what amounts are intended to be reported in these two boxes as soon as possible so that the basis reporting systems being developed calculate and capture the required reportable amounts.

In addition, brokers need to know when box 15 (Check if loss not allowed based on amount in box 2) is expected to be checked. Is this box to be used only if NO loss on the sale is recognized for tax purposes (i.e., the box should not be checked if a loss is partially disallowed)? Is this box to be used only for corporate inversions that are otherwise reportable on Form 1099-CAP? Should box 15 be checked to indicate that a loss realized on a tax-free reorganization with boot may not be recognized, assuming the loss is reportable? If the amount of a loss disallowed under the wash sales is reported in box 5, then we believe it should not also be necessary to check box 15.

Description of Security Sold. SIFMA is pleased to see that boxes 5 (No. of shares exchanged) and 6 (Classes of stock exchanged) of the Form 1099-B for 2010 are not included in the draft Form 1099-B for 2011. These boxes are currently required to be used by a broker only in reporting an exchange of stock that results from a change in control or a substantial change in capital structure as described in Code section 6043(c) and the applicable regulations. Such exchanges are relatively rare in occurrence and often reported manually. This information is not needed to be separately reported because such information can be included, where applicable, as part of the "Description" of the security sold in box 7. Second, the deletion of these boxes eliminates any possible confusion by brokers who need not separately report this information for other types of sales and redemptions of stock. If the IRS had intended that brokers separately report these elements of a security description for all reportable sales, it would require a substantial re-programming of legacy broker reporting systems and a re-work of some security master files that use free formats for a security description or rely primarily on security identifiers (such as CUSIP numbers) to identify the class or other attributes of a security.

SIFMA appreciates your consideration of its collective views and concerns on the finalization of the Proposed Regulations. Please do not hesitate to contact me at (202) 296-7333 or emccarthy@sifma.org if you have any questions or if we can be of further assistance.

Sincerely,

N. Ellen McCarthy

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