



**Important Cost Basis
Information for
Transfer Agents:**
*Understanding Key Aspects
of the Proposed Regs*

Stevie D. Conlon
Senior Director & Tax Counsel
Wolters Kluwer Financial Services
GainsKeeper
Securities Transfer Association Webinar
May 12, 2010



New Regulatory Obligations for Transfer Agents

- Cost basis reporting applies to transfer agents
- Transfer agents must be prepared to deliver and receive cost basis information within 15 days of date securities are transferred
- Transfer agents must manage and maintain cost basis data at the more detailed tax lot level (rather than at the position level)
- Transfer agents will need mechanisms to transfer cost basis information if there is a change of agents

Boundaries

- Focus on transfer agents
- Not addressing average basis calculations
- Not addressing dividend reinvestment plan (DRP) stock
- Securities Transfer Association is planning future webinars that will address practical “how to” aspects of cost basis reporting with presenters from the transfer agent community

DTCC, ACATS and CBRS

- DTCC has an existing tax basis related service for securities transfers called “CBRS” (seabreeze)
- DTCC has announced that it is enhancing CBRS
- DTCC is expanding the service to permit its use by “...transfer agents, issuers, mutual funds, custodian banks and broker/dealers to move cost basis information...”
- Transfer agents should stay alert for developments regarding the availability of updated CBRS service

Cost Basis Reporting Applies to Transfer Agents

- Current IRS Form 1099 reporting does not generally apply to transfer agents
- In addition to requiring cost basis reporting on Form 1099, the cost basis law also added new Code Sec. 6045A, imposing “transfer reporting” of cost basis information on “applicable persons”
- Proposed Reg. Sec. 1.6045A-1(a)(3) defines an applicable person as: (1) any broker subject to Form 1099-B reporting; (2) any custodian of securities; (3) any issuer of securities; and (4) any agent of these persons
- A transfer agent is likely to fall under this definition and will therefore be subject to transfer reporting

Cost Basis Reporting Application

■ Applies to “covered securities”

- Stock acquired on or after Jan. 1, 2011
- Mutual fund and DRP stock acquired on or after Jan. 1, 2012
- Debt and options acquired on or after Jan. 1, 2013
- Anything else the IRS decides to add, effective for any specified date after Jan. 1, 2013

■ Transfer reporting also applies to non-covered securities

■ Foreign stock, REITs and foreign mutual funds and ETFs are subject to the Jan. 1, 2011 effective date

■ WHFITS and partnership interests are carved out

■ Concerns have been raised regarding application to foreign brokers and foreign partnerships

Transfer Reporting Requirement Penalty Risk

- An “applicable person” must provide a receiving broker with a cost basis transfer statement within 15 days of the date securities are transferred
- A cost basis transfer statement is included in the definition of a “payee statement” subject to tax penalty risks for incorrect and late returns under Code Sec. 6724(d)(2)(l)
- The penalty is \$50 for each payee statement (up to \$100,000 annually) if the statement is late or not complete (unless the failure is due to intentional disregard) Code Sec. 6722]
- If the failure to provide the statement is due to intentional disregard, the penalty is 10% of the amount that should have been reported (without limit)

Transfer Reporting Key Details

- Applies when an applicable person transfers custody of a specified security (stock, mutual fund share, etc.) to a broker in a transaction that is not a sale
- A separate statement must be furnished for each security and for each tax lot
- Transfer statement must be in writing unless both transferor and transferee agree to a different format
- No transfer statement required for transfers within the same entity or affiliated entities provided all required cost basis information is incorporated into the records of the recipient account
- Special reporting rules apply to inheritance and gift transfers—need to know the reason for transfers to accounts in the name of other persons

Required Transfer Statement Information

- Date statement is furnished and date of any prior stmt
- Applicable person transferor (name, address & phone)
- Broker receiving custody (name, address & phone)
- Beneficial owners of security (name, address, phone, taxpayer ID, account number prior to transfer) before and after transfer
- Security identifiers (CUSIP or other IRS designated ID), quantity of shares/units, security symbol (if app.), lot numbers (if app.) and tax classification of security (such as stock)
- Transfer dates—date initiated and settlement date (if known)
- Adjusted basis, acquisition date and holding date
- Corporate action ID and/or description of other corporate action adjustments

Corporate Actions and Wash Sales

- The transfer statement requirements provide that corporate actions reported on issuer statements do not need to be taken into account
- Brokers adjust for corporate actions in reporting basis on Form 1099-B but applicable persons do not in providing transfer statements
- This “exemption” has been criticized in industry comments
- There is no similar carve-out for wash sale calculations
- If corporate actions are taken into account, the transferor must report the ID number of the last reported corporate action (what about earlier actions?) or describe it if no issuer report

Wash Sales

- Wash sale rule of Sec. 1091 generally defers losses and affects basis and holding period of newly acquired securities if securities are sold at a loss and within the 61 day period beginning 30 days before the date of the loss and 30 days after, the taxpayer acquires substantially identical securities
- Two common errors in wash sales calculations:
 - Incorrect holding period adjustments
 - Incorrect adjusted basis if lots are purchased and sold in different quantities
- Existing IRS regulations are clear that if the size of the loss lot and the purchase lot differ, only an equal number of shares of the new lot are adjusted:

“the particular shares of stock or securities the acquisition of which resulted in the nondeductibility of the loss shall be those with which the stock or securities disposed of are matched ...” Reg. 1.1091-1(d)

Transfers of Less than the Entire Position

- Transferor must report transfer on a first-in/first-out (FIFO) basis unless customer notifies the applicable person by making an adequate and timely identification of tax lots under Prop. Reg. 1.1012-1(c)
- Transferors will want to ask customers which lots they want to select
- The selection will need to be timely—IRS does not permit the selection of lots after the settlement date for the transfer
- It is not clear that a transferor can rely on a standing order for sales of securities to determine the lots selected upon transfer
- Concerns with physical stock certificates—earliest lot rule (Prop. Reg. 1.1012-1(c)(1))

Non-Covered and Exempt Recipient Transfers

- Transfer reporting does not merely apply to covered securities (securities acquired after the effective date of the cost basis law)
- Applicable persons must also report transfers of non-covered securities
- For non-covered securities, the adjusted basis, acquisition date and holding date do not need to be provided—nor does the additional information relating to inheritance and gift transfers
- Transfers of securities to exempt recipients must also be reported—however, the securities are treated as non-covered so adjusted basis, acquisition date and holding date do not need to be provided
- The net effect is that there is still a significant reporting burden for transfers of non-covered securities
- Non-specified securities (securities of a type besides stock, mutual fund shares, debt securities and options) should not be subject to transfer reporting

Inheritance Related Transfers

- Transfer statement must indicate that the transfer consists of an inherited security
- Statement must report the date of death as the original acquisition date and report the adjusted basis according to instructions or values provided by authorized representative of the estate
- If authorized representative of the estate does not provide the instructions or valuations regarding basis, the applicable person must ask the representative for the information
- Applicable person only has to ask for the information once
- If the information is not timely received, the transferor must indicate that the security is inherited but can otherwise report it as a non-covered security
- If the applicable person later receives the information (with no cut-off date), a corrected transfer statement must be provided within 15 days reporting the security as covered

Gift and Change of Ownership Related Transfers

- Transfer statement must indicate that the transfer consists of a gift and report the date of the gift
- Statement must report the adjusted basis, acquisition date and holding date of the donor
- Statement must also report the fair market value of the security on the date of the gift (if known when furnishing the statement)
- If the securities are subsequently transferred to a different account of the same owner, the applicable person must include the additional gift related information set forth above
- If a transfer affects a “change of ownership” - securities are transferred from an account of one person or persons to the account of another person (that does not share at least one common owner)—the applicable person must report the transfer as a gift (and obtain the required information if available) unless the transfer is between persons for whom gift-related basis adjustments are inapplicable—Transferor will need to know WHY

Obligation to Correct Statements & Data Storage

- If additional information becomes available later, an applicable person must provide a corrected transfer statement
- There is no “*de minimis*” rule
- There is no “cut-off” date
- There can be a cascading effect if someone earlier in the chain updates and corrects their returns/statements
- It seems highly likely for inheritance related transfers or due to corporate actions
- There is no expiration date for when a transferor would no longer need to retain cost basis related information

Conclusion

- Cost basis transfer reporting imposes significant burdens for transfer agents
- IRS penalties of 10% of the amount reported for intentional disregard (without limit) makes compliance a necessity
- Systems will need to be updated to manage this burden
- The DTCC CBRS system is being enhanced to assist in transfer reporting
- The scope of transfer reporting, its application to foreign stocks and mutual fund shares and the special rules for inherited and gifted shares will be surprising
- Adjustments for corporate actions will require a new corporate action ID number or an explanation
- Adjustments for wash sales will be difficult

Considerations

- Wolters Kluwer Financial Services does not provide tax advice. You should consult your own tax advisers and they (and not Wolters Kluwer Financial Services, GainsKeeper or Capital Changes) are solely responsible for any tax, tax penalties or interest related to their tax returns
- GainsKeeper is a tool to assist taxpayers but does not cover a variety of specific tax rules or taxpayer circumstances and facts