

**INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)**

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

Lisa M. Chavez  
Chairperson

July 6, 2010

**Ad Hoc  
Sub-Group:**  
Stephen LeRoux, Chair  
Joan Hagen  
Kathy Ploch

Mr. Stephen Schaeffer  
Office of Associate Chief Counsel (Procedure & Administration)  
CC:PA:LPD:PR (REG-101896-09)  
Courier's Desk

**Burden Reduction  
Sub-Group:**  
Barbara McArthur, Chair  
Jerri Langer  
Constance Logan  
Kathryn Tracy  
Arthur Wolk

Internal Revenue Service  
1111 Constitution Avenue N.W.  
Washington, DC

Dear Mr. Schaeffer:

**Emerging Compliance  
Issues  
Sub-Group:**  
Douglas Borisky, Chair  
Candace Ewell  
Donald Morris  
Marjorie Penrod  
Paula Porpilia  
Susan Segar

On February 26, 2010, the Information Reporting Program Advisory Committee (IRPAC)<sup>1</sup> submitted a letter to the IRS commenting on the proposed cost basis regulations.<sup>2</sup> Since providing those comments, IRPAC has had the opportunity to further consider the proposed regulations and requests in this letter that the IRS provide clarification in the final regulations regarding the following three additional issues: (1) whether a customer must take an affirmative action to "elect" to the broker's default method for calculating the cost basis of mutual fund or dividend reinvestment plan ("DRP") shares, (2) whether a broker can make a single account election during the one year period in which a customer can revoke an election to use the average basis method, and (3) how the single account election should be applied to joint accounts of a customer. Each of these issues is discussed below.

**Employee  
Benefits/Payroll  
Sub-Group:**  
Elizabeth Dold, Chair  
Lisa Germano  
Leonard Jacobs  
Philip Kirchner  
Anne Lennan  
Emily Lindsay

**Customer's Election of Broker's Default Method**

**Tax Cap  
Sub-Group:**  
Eric Toder, Chair  
Marsha Blumenthal  
Charles Christian  
Andrew Lyon  
Lillian Mills  
George Plesko  
George Yin

The regulations require that, with respect to mutual fund or DRP shares, the customer must use the broker's default method of basis calculation unless the customer elects to use another valid method.<sup>3</sup> The question at issue is whether a customer that is notified of the broker's default method and passively accepts such method has made an "election" to use the broker's default method. Stated differently, is a customer required to make an affirmative election to use the broker's default method, or does a customer make an effective election by passively accepting a broker's default method? The need for clarification arises primarily when a broker's default method is the

<sup>1</sup> IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

<sup>2</sup> REG-101896-09, 74 FR 67009 (Dec. 17, 2009).

<sup>3</sup> Prop. Reg. § 1.1012-1(e)(2).

average basis method, and the customer, as permitted by the regulations, wants to change from the average basis method to the separate basis method.

By way of background, the proposed regulations provide that a customer that has "elected" to use the average basis method has until the earlier of its first sale or one year (or such longer period as the broker allows) after the election to "revoke" the election.<sup>4</sup> The effect of such revocation is that the broker is required to "turn back the clock" and recompute the basis of shares as if specific identification method of basis computation had always been in effect for the shares. One of the main benefits of the average basis method is that the separate cost basis of each share generally does not need to be maintained after the share is added to the averaging pool.<sup>5</sup> The proposed regulations seem to acknowledge the practical limits on how long brokers could or should maintain separate basis information by establishing the one year limit for which the customer may revoke its average basis method election (unless the broker allows the revocation beyond the year time frame.)

If a customer's acceptance of the average basis method as the broker's default method is considered an effective election, then the customer's one year period for revoking such election would presumably begin upon such acceptance, and thus limit the time frame for which the broker is obligated to retain the separate basis information of shares purchased by the customer. On the other hand, if customer's passive acceptance of the broker's default method is not effectively a cost basis method election; it is not clear if the customer can change from the average basis method to the specific identification method, and if so, whether there is any time frame for which the customer can switch to the specific identification method. Assuming such a switch were allowed, it is not difficult to imagine a situation where the customer makes monthly purchases of shares in a mutual fund for five or ten years without making any sales before focusing on the issue of the basis determination method. If the customer has passively accepted the use of the average basis method (i.e., the broker's default method), should the broker be required to restore the separate basis of 60 or 120 purchases? This result would seem to undermine the utility of the one year cut-off on revocations. What if the broker no longer has the separate basis information?

The availability of the single-account election is also in doubt when the broker's default method is the average basis method. The single-account election allows the broker to treat all shares subject to the averaging as a single pool even if they are in different accounts. Only the broker can make the single-account election, and may do so only if the customer "elects" to use average basis.<sup>6</sup> If defaulting into average basis is not considered an election, then the broker cannot make a single-account election.

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<sup>4</sup> Prop. Reg. § 1.1012-1(e)(9)(iii).

<sup>5</sup> We note that, regardless of which basis method is used, the proposed regulations seems to require a broker to maintain the acquisition date of all shares purchased for purposes of determining whether a gain or loss on the sale of the shares is long- or short-term at least for five years. See Prop. Reg. § 1.6045A-1(b)(1)(vii). Please see the February 8, 2010 comment letter from the Investment Company Institute for further information on this point.

<sup>6</sup> Prop. Reg. § 1.1012-1(d)(11)(i).

**IRPAC Recommendation:** The regulations should be clarified regarding the effect of a customer's passive acceptance of a broker's default method. IRPAC believes that a customer's passive acceptance of the average basis method as the broker's default method should be considered an effective election.

**Customer's Revocation of Average Basis Method after Broker Single Account Election**

As noted above, a customer that has elected to use the average basis method may revoke such election before its first sale of average basis shares, provided it does so within a year (or such longer period as the broker allows). The proposed regulations also allow a broker to make single-account election with respect to stock for which a customer elects to use the average basis method that is held in separate accounts or treated as held in separate accounts maintained by the customer.<sup>7</sup> A broker's single account election is irrevocable.<sup>8</sup> The election can be made at any time.<sup>9</sup> Thus, it appears that a broker can make a single account election during the one year (or more) period during which the customer can revoke its average basis method election. It is not clear whether the irrevocable nature of the broker's single-account election overrides the revocability of the customer's average basis election.

If the customer can in fact override a broker's single-account election, and revoke the average basis method, there is also the question of how the basis of the single-account election shares should be calculated. When the broker makes a single-account election, noncovered shares for which the broker has basis information may become covered.<sup>10</sup> If the customer revokes the average basis method, do those shares go back to being noncovered?

**IRPAC Recommendation:** The effect of a single-account election during the period in which a customer can revoke its average basis method calculation should be clarified in the regulations.

**Application of Single Account Election of Joint Accounts**

The single-account election allows a broker to elect to treat all identical shares of mutual fund or DRP stock held (or treated as held) by a customer in separate accounts as held in a single account. IRPAC requests clarification on the scope of customer accounts that can be covered by the single-account election. Specifically, can the single-account election be made only with respect to accounts held solely by a single customer or can it also be made with respect to joint accounts of the customer, including both spousal and non-spousal joint accounts?

**IRPAC Recommendation:** The effect of a single-account election on joint accounts should be clarified in the regulations.

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<sup>7</sup> Prop. Reg. § 1.1012-1(e)(11)(i).

<sup>8</sup> *Id.*

<sup>9</sup> Prop. Reg. § 1.1012-1(e)(10)(iv).

<sup>10</sup> See Prop. Reg. § 1.1012-1(e)(11)(iii).

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IRPAC appreciates the opportunity to present further comments to you on the proposed cost basis regulations and remains committed to assisting the IRS in finalizing these rules. If you have any questions, we will be happy to further discuss this with you.

Sincerely,

A handwritten signature in cursive script that reads "Lisa M. Chavez". The signature is written in black ink and includes a long horizontal flourish at the end.

Lisa M. Chavez  
2010 IRPAC Chair