



Securities Industry Association

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September 26, 2003

CC:PA:RU (Notice 2003-53)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Coverdell ESA Reporting

Dear Ms. Rosenbaum:

The Retirement & Savings Committee of the Securities Industry Association (SIA)¹ appreciates the opportunity to comment on Internal Revenue Service (IRS) Notice 2003-53, relating to the recently issued Forms 1099-Q and 5498-ESA. SIA is pleased the IRS has postponed the reporting requirements to report the earnings and basis portions of distributions. This delay provides all interested parties time to fully consider the implications of this new requirement for taxpayers, the financial institutions, and the federal government.

As sponsors of Coverdell ESAs (ESAs), we share your goal of accurate and timely reporting of distributions from these accounts and securing the information needed for proper tax reporting. Yet, as we indicated in our original letter submitted on May 15, 2003, we have concluded that some of the information requested on these revised forms, specifically the cost basis of distributions, may be impossible to obtain and in most cases the taxpayer is the best or only source of cost basis information. We strongly urge the IRS to reconsider the requirement to report the basis portion of distributions.

Availability of ESAs

It appears that the requirement to report the basis of ESA distributions is based in part on an intent to align the reporting requirements for ESAs with those of Qualified Tuition Plans (529s). While there are similarities between the two types of

¹The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated \$222 billion in domestic revenue and \$356 billion in global revenues.

accounts, i.e., the assets are to be used for education; contributions are generally after-tax; distributions are tax-free if used for education; etc. from the perspective of the financial services industry, the ESA is most similar to and has been administered most like Roth IRAs.

As we have discussed previously, the ability to initially offer Coverdell ESAs was possible only because financial institutions were able to utilize existing record-keeping systems that were utilized for IRAs. Without this ability, many financial institutions would not have been able to offer the ESAs because of the low contribution limits, existence of income limits, and the ability to withdraw the money for primary and secondary school expenses, all of which had the effect of depleting the accounts over a relatively short time frame. Only when the limit was increased to \$2,000 did more financial institutions consider sponsoring an ESA product.

With the troubling new requirement to track and report basis, institutions are unable to justify the investment needed to upgrade their systems to comply with these requirements. As a result, only a handful of institutions will continue to offer these accounts if this requirement remains in place. Some have suggested that institutions offering 529 plans will want this business. However, the comparison is not necessarily valid. ESA contribution limits are much smaller than the limits that exist for 529 plans, taxpayers may make withdrawals for primary and secondary education expenses leaving a shorter time for asset growth, and the accounts must be exhausted by age 30. 529 plan assets may only be used for post-secondary education and have substantially higher contribution limits. Servicing ESAs profitably with the increased recordkeeping requirements is unlikely, resulting in less marketing and fewer opportunities for the public to save with ESAs and the likely abandonment by financial institutions.

Possible Sources for Basis Information

In Notice 2003-53, the IRS asked for comments on potential methods to establish basis for ESAs. Unfortunately, SIA does not believe that any current documents would establish basis in a way that would be accurate. As we understand the requirement, the basis report is a *calculated* amount based on a formula that takes into account both contributions and distributions. Only the taxpayer has access to this information. Asking the taxpayers to provide this information to their custodians will not improve compliance and where clients do respond, we expect inconsistent and inaccurate financial information.

Form 8606, which has been used to report distributions from Coverdell ESAs for taxable years prior to 2002, contains the following statement in the Instructions for Recipient, "For distributions from a Roth IRA, generally the payer is not required to compute the taxable amount. You must compute any taxable amount on Form 8606..." We strongly urge the Service to continue to place the responsibility for reporting the taxable amount of a distribution on the taxpayer, who is the only party with the requisite information to compile and report this information.

SIA respectfully points out that if the taxpayer can be relied on to accurately report this information for a Roth IRA -- a much more widely used account -- and was also asked to report similar information for Coverdell ESAs on Form 8606 prior to 2003, then surely the Service can continue to rely on the taxpayer to report this information for a Coverdell ESA. Moreover, the methodology for calculating basis and earnings can be found in IRS Publication 970, which taxpayers can consult when filing their returns.

Given the very small revenue at stake (up until 2003, the most one could have contributed to an ESA in total was \$4,000; account balances are in fact at about \$1,000), we believe the IRS should continue to rely on Form 8606 and taxpayers for this information.

Taxpayers do receive timely and complete information from custodians regarding their contributions and distributions. Generally, financial institutions provide a year-end statement that includes a cumulative contribution amount. Under the new proposed instructions, total distributions for the year are reported to taxpayers on Form 1099-Q. In order to perform these calculations, taxpayers must simply maintain two documents each year, at no additional cost to them or to the financial institution maintaining the account. It makes little sense for the IRS to ask custodians to comply with the proposed new requirements to track this information on a "life" basis and then calculate the basis at substantially greater time and expense when the responsible individual is provided this information and has always had a responsibility to retain records and perform the basis calculations. SIA would agree that additional disclosures on these year-end statements could warn taxpayers to retain these documents for use in filling out Form 8606.

Calculations on Excess Contributions

Notice 2003-53 seems to add a new requirement for excess contributions. The Notice states that the trustee or custodian will be in compliance if the 1099 includes in box 2 the amount of any earnings on excess contributions, *computed using the method for calculating the net income attributable to IRA contributions*. While we are aware of these requirements and some financial institutions provide a worksheet to clients to assist in making this calculation, SIA members do not perform the calculations for clients and are not required to do so. SIA recommends that this new instruction be withdrawn as it will create additional burdens for firms, similar to those discussed previously.

Form 5498-ESA

Form 5498-ESA has also been issued for 2003 and the new reporting requirements present problems. Contributions received as late as April 15th and that are made for the preceding year must be reported to the "beneficiary (participant) by April 30". This reporting schedule would be extremely difficult, if not impossible, to meet. If the custodian was required to issue the 5498-ESA by April 30th, and a contribution was made slightly before April 15th for the preceding year, there would not be enough time to

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process the transaction and issue a regulatory report. An April 30th notification date also would have to report “excess” contribution corrections. Unlike an IRA, in a Coverdell-ESA this can be done through June 1st. Normally, the deadline for providing a copy of form 5498 to a taxpayer is May 30th. At the very least, we suggest that this deadline also apply to 5498-ESA, although it makes more sense to make the filing deadline June 30th, or some date after “excess” contributions can be corrected.

SIA understands that this problem may need to be addressed through legislation. In that event, we encourage Treasury to work with the committees of jurisdiction to quickly address this problem.

In closing, SIA supports the Service’s issuance of Forms 1099-Q and 5498-ESA and its effort to distinguish Coverdell ESAs from “traditional” retirement plans. However, we urge reconsideration of the requirement to report the basis of distributions on Form 1099-Q, the new requirement to calculate earnings on excess contributions, and the establishing of a more reasonable reporting deadline. If you have any questions about our comments, please do not hesitate to contact me at (202) 216-2032.

Sincerely,

Liz A. Varley

cc: Susan Brown
U.S. Department of Treasury

Margaret Salow
Internal Revenue Service

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