



Securities Industry Association

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August 14, 2001

Internal Revenue Service
CC: M&SP:RU (REG – 246249-96)
Room 5226
Ben Franklin Station
Post Office Box 7604
Washington, DC 20024

Re: Proposed Regulations on Information Reporting for Certain Payments
Made On Behalf of Another Person, Payments to Joint Payees, and
Payments of Gross Proceeds From Sales Involving Investment Advisers
(REG – 246249-96)

Dear Sir/Madam:

Late last year the Treasury Department and the Internal Revenue Service (the "IRS") published proposed regulations under section 6045 of the Internal Revenue Code (the "IRC") to clarify and amend the information reporting requirements on sales effected by brokers for their customers ("broker reporting"). REG-246249-96. In particular, the proposed regulations restate and amend (1) the list of types of payees who are exempt from broker reporting ("exempt recipients") and (2) the list of types of transactions that are not subject to broker reporting. In response to the proposed regulations, the members of the Committee on Tax Compliance and Administration of the Securities Industry Association ("SIA")¹ appreciate the opportunity to provide their suggestions for further clarifying the proposed regulations and conforming them to present business practices. The Committee members represent brokers who regularly prepare and file information returns on Forms 1099-B respecting broker transactions.

¹ The Securities Industry Association brings together the shared interests of nearly 700 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. The U.S. securities industry manages the accounts of nearly 80-million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2000, the industry generated \$314 billion of revenue directly in the U.S. economy and an additional \$110 billion overseas. Securities firms employ approximately 770,000 individuals in the U.S. (More information about SIA is available on its home page: <http://www.sia.com>.)

Summary of Comments

Our primary suggestions for improving the proposed regulations are summarized below:

- Conform the list of exempt recipients for reporting gross proceeds from sales of securities with the recently updated list for reporting interest and dividend payments.
- Exclude from gross proceeds reporting periodic paydowns of principal on debt obligations.
- Clarify whether payments in kind may be reported as gross proceeds on Form 1099-B.

I. Conform the List of Exempt Recipients.

No information return is required under section 6045(a) for a sale effected by a broker on behalf of an exempt recipient. Proposed regulation section 1.6045-1(c)(3)(i)(B) defines the term “exempt recipient” to include the types of entities that are listed there. Further, a broker may treat a payee as an exempt recipient based on an exemption certificate (e.g., Form W-9) or the broker’s actual knowledge of the payee. Prop. Reg. Section 1.6045-1(c)(3)(i)(C). In the absence of an exemption certificate, how should a broker or bank demonstrate its actual knowledge of the reporting status of its payees? Does the broker or bank have a duty to inquire about the payee’s status? The proposed regulations do not contain any safe harbors to enable brokers to reliably identify exempt recipients without an exemption certificate.

In contrast, the IRS recently expanded and updated the list of exempt recipients under Regulation section 1.6049-4(c)(1)(ii) for reporting payments of interest (including original issue discount) on securities. See T.D. 8734. By cross-reference, this list of exempt recipients also applies to payments of dividends reportable on Form 1099 under section 6042. The list includes types of payees that are not included in the proposed regulations, such as section 403(b)(7) custodial accounts, charitable remainder trusts, swap dealers and nominees. The section 6049 regulations also provide useful guidance on how to identify exempt recipients based on their names without requiring exemption certificates.

Brokers (including banks) who effect sales of securities for customers often also act as custodians of those securities. In their capacity as custodians, brokers and banks routinely collect dividend and interest income on securities on behalf of their customers and prepare information returns for non-exempt recipients under sections 6042 and 6049. Since the payee may receive both

income payments and sales proceeds on the securities from the same broker or bank, the payee should have the same reporting status for all payments made with respect to the securities. In practice, the reporting status of a payee that maintains a custodial account with a bank or broker is based on the person whose name is shown on the account. Brokers and banks are not readily able to identify a payee as an exempt recipient for one type of payment and as a non-exempt recipient for another type of payment made to the same account.

We believe it is important to the smooth administration of the information reporting regime that the list of exempt recipients and the rules for identifying exempt recipients under section 6045 be the same as those under sections 6042 and 6049. Accordingly, we urge the IRS to conform the two lists and adopt a uniform standard for identifying exempt recipients.

II. Expand the Types of Excepted Sales.

Proposed regulation sections 1.6045-1(c)(3)(vi) through (ix) describe sale transactions which are excepted from information reporting on Form 1099-B because they produce no taxable capital gain or loss. These exceptions are based on the well founded legislative intent that the gross proceeds reporting requirement cover sales and exchanges that result in capital gain or loss to the taxpayer. See Report of the Senate Finance Committee on H.R. 4961, S. Rep. No. 97-494, Vol. 1 (July 12, 1982) at 245-246. This legislative policy is not served by reporting transactions that are not treated as dispositions of securities for tax purposes.

Under the terms of mortgage-backed securities and ownership certificates evidencing an interest in other types of loans or receivables, the investor receives periodic payments of principal on the underlying pool of loans over an extended period of time. For tax purposes, these periodic payments are not treated as a disposition or a retirement of the security, but are an adjustment to the taxpayer's basis in the security. IRC section 1016(a)(1). In 1985, the IRS concluded in Private Letter Ruling 8520058 (February 19, 1985) that a broker was not required report on Form 1099-B the periodic payment of principal on government-backed loans, such as Ginnie Mae mortgage pass-through certificates. Based on this ruling, reporting is not required until there is a disposition of a debt obligation by retirement or a sale prior to retirement.

At present, there are inconsistent practices and confusion in the payor community as to reporting on periodic payments of principal. Payors who do not report these payments believe, consistent with the above described letter ruling, that such payments do not constitute a retirement of a debt obligation. Others are not comfortable relying on this interpretation of the regulations in the absence of a revenue ruling, revenue procedure or a specific regulatory exception to reporting. The inconsistent practices are confusing to taxpayers who receive information returns from multiple payors. Furthermore, the IRS is burdened by a

significant volume of useless information returns. Finally, uncertain payors incur the expense of preparing and filing unnecessary information returns.

For these reasons, we believe that the reporting requirement should be clarified and that periodic principal payments should be added to the list of excepted transactions in the proposed regulations. For information reporting to be an effective tool in the enforcement of tax compliance, the reporting rules need to be clear in their application. For a detailed discussion of this issue, please see the IRPAC paper “Gross Proceeds Reporting on Periodic Payments of Principal on ‘Debt Obligations’” as presented at the November 16, 2000 public meeting.

III. Payments in Kind.

Of concern to many brokers is whether they may report gross proceeds from exchanges treated as redemptions for tax purposes when the payment is made in kind, in whole or in part. Regulation section 1.6045-1(a)(9) defines the term “sale” as “any disposition of securities, commodities, regulated futures contracts, or forward contracts for cash, and includes redemptions of stock, retirements of indebtedness, and enterings into short sales [emphasis added].” In private letter rulings, this provision has been interpreted to mean that dispositions of stock must be reported on Form 1099-B where the consideration paid is cash only. Where the consideration consists of property and minimal cash, no reporting is required under section 6045. See Private Letter Ruling 8617063 (January 28, 1986).² If this continues to be correct, then, stock exchanged or redeemed, in whole or in part, for property other than cash is not required to be reported on Form 1099-B and should be added to the list of excepted sales in Proposed Regulation section 1.6045-1(c)(3).

Where a corporation offers to purchase its own stock (commonly known as a “self tender”), the purchase is considered a redemption of stock only if the transaction meets one of the tests in IRC section 302(b): (1) the shareholder’s interest in the corporation is completely terminated, (2) the transaction is substantially disproportionate to that particular shareholder or (3) the transaction is not “essentially equivalent to a dividend”. 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 criteria, it is treated as a distribution with respect to stock under IRC section 301 and is taxed as ordinary dividend income to the extent of corporate earnings and profits. These tax principles also apply where a corporation effects a taxable stock for debt exchange. In several private letter rulings, the IRS has stated that these transactions are not required to be reported as sales on Form 1099-B, apparently

² For a contrary result, see Private Letter Ruling 8916007 (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.

because they involve payments in kind, but has concluded that they are reportable as dividends on Form 1099-DIV. In each of these rulings, the payor had represented that different shareholders would be treated differently for tax purposes and that a significant number of shareholders would qualify for exchange treatment. The IRS acknowledged that a payor does not ordinarily possess the shareholder specific facts and circumstances that are necessary to determine the tax character of the transaction as to each shareholder. To accommodate this inherent difficulty, it allowed the payors to report these transactions as redemptions on Form 1099-B, instead of as dividends on Form 1099-DIV, provided that the Form 1099 was accompanied by a written statement that explained the possible tax consequences of the transaction. See Private Letter Rulings 8617063 (January 28, 1986), 8920007 (February 2, 1989), 8850004 (August 31, 1988), 9017047 (January 30, 1990), and 8617068 (January 28, 1986).

Similar reporting issues arise 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 taxable at capital gains rates, unless under IRC section 356(a)(2) the exchange has “the effect of the distribution of a dividend”. The principles of IRC 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. Given the multitude of possibilities for each shareholder and uncertainties in the application of the tax law, it is doubtful that a payor can accurately determine the amount of taxable income in these situations. If information reporting on these transactions is required under IRC section 6042 on Form 1099-DIV, we ask that brokers be allowed instead to report the full value of the boot as gross proceeds on Form 1099-B. The IRS, in Private Letter Ruling 9015012 (January 9, 1990) granted a corporation this latitude in the context of an “E” reorganization.

Since the authorities cited are private rulings that bind the IRS only with respect to the taxpayer that requested the ruling, SIA would appreciate regulatory guidance that confirms that a broker acting in the ordinary course of its business can report such transactions on Form 1099-B, in lieu of Form 1099-DIV, where different shareholders are likely to receive different tax treatment. This would resolve the present uncertainty and promote consistency in information reporting for taxpayers. The proposed regulations present the IRS with an ideal opportunity to clarify the reporting responsibilities of the broker community.

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Thank you for your consideration of our views. If you would like to discuss any of the matters raised in this letter further, please contact Patricia McClanahan, SIA Vice President and Director of Tax Policy, at (202) 326-5324.

Sincerely yours,

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