



Securities Industry Association

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CC:ITA:RU (REG-143321-02)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20244

RE: Information Reporting Relating to Taxable Stock Transactions

Dear Sir or Madam:

The Securities Industry Association (SIA)¹ appreciates this opportunity to comment on the proposed and temporary regulations (Reg-143321-02) with respect to tax reporting for corporate inversions and other taxable stock transactions (the "Proposed Regulations").

As an initial matter, SIA wishes to thank the Internal Revenue Service (the "IRS") for working with our industry to provide crucial transition rules for transactions occurring in 2002. Announcement 2003-7 provided securities firms with much-needed flexibility in communicating the taxability of re-incorporations offshore to affected shareholders.

SIA has the following four recommendations that it would like the IRS to consider prior to finalizing the Proposed Regulations:

- 1.) The IRS should require that corporations communicate taxable stock transaction information to the financial community.

¹ The Securities Industry 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. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States.

- 2.) Brokers should be allowed to furnish Form 1099-B in lieu of Form 1099-CAP to the actual owners of stock.
- 3.) Brokers should be allowed to report the cash and the fair market value amounts either as a single transaction or as separate transactions.
- 4.) The IRS should permit payers to combine Form 1099-CAP with Forms 1099-B, 1099-DIV, 1099-INT, 1099-OID and 1099-MISC (royalties) in a consolidated payee statement.

I. The IRS should require that corporations communicate taxable stock transaction information to the financial community.

The Proposed Regulations rely on the mechanism of "cascading" Forms 1099-CAP to get tax information concerning an acquisition of control of, or a substantial change in the capital structure of a domestic corporation to the actual owners of the corporation's stock. The Proposed Regulations first require corporations to furnish Forms 1099-CAP with respect to such transactions to their shareholders that are brokers or record holders for the actual owners of their stock. Reg. §1.6043-4T(b)(6)(iii)(K). This rule departs from the typical rule that brokers (including banks) and other nominees are treated as exempt recipients for which no Form 1099 is required. The Proposed Regulations then use the Form 1099-CAP furnished by the corporation to the broker as the trigger for requiring reporting by brokers to actual owners. Reg. §1.6045-3T(a). For the reasons explained below, we believe that the reporting regime set forth in the Proposed Regulations would not be a reliable or effective means of furnishing tax information to the actual owners of stock.

The most basic problem with the Proposed Regulations is that they do not provide for a complete "information chain" of Forms 1099 from the corporation to the actual owners of its stock. As the rules are written, brokers in many cases would not receive a Form 1099-CAP. Brokers would not ordinarily receive Forms 1099-CAP directly from the corporation. While brokers often hold securities as a nominee for the actual owners, brokers normally do not hold securities directly with the corporation or its paying agent. Instead, brokers hold over 80 percent of all securities in "street name" through a clearing organization (e.g., The Depository Trust Company). The clearing organization, in turn, typically holds the securities in the name of its nominee (e.g., Cede & Co.). Thus, a corporation or its paying agent may know only the clearing organization's nominee as its shareholder. Brokers currently rely on clearing organizations for income payments and information concerning corporate actions (e.g., exchanges, mergers), because brokers do not usually receive payments or communications directly from corporations. However, under the Proposed Regulations there is no requirement for a clearing organization to furnish a Form 1099-CAP to the brokers for whom it holds shares as nominee, since a clearing organization (or its

nominee) is not a broker (as that term is defined in Reg. §1.6045-1(a)(1)). Thus, the proposed chain of Forms 1099-CAP is broken.

Even if brokers actually received a Form 1099-CAP with respect to a given transaction, practical problems would remain. Many corporations and their dividend disbursing agents voluntarily provide information returns to exempt recipients as well as to non-exempt recipients. The Forms 1099-CAP therefore would be among thousands of other tax reporting documents (e.g., 1099-DIV, 1099-INT) received simultaneously by brokers. There will be difficulties isolating the few Forms 1099-CAP received. Further, information returns are not all addressed to the same location within a large organization. Realistically, a broker could never be confident that it had received or found all the necessary information returns. Finally, even if the broker were to locate a Form 1099-CAP, the information reported on the form could not readily be used to prepare Forms 1099-CAP for the actual owners. This is because the amount of cash and the fair market value of stock and/or other property reported on the Form 1099-CAP would apply to the aggregate number of shares exchanged by the broker for all of its customers. Instead, brokers need to know the amount of cash, the fair market value of stock and the fair market value of other property received for each share of stock actually or deemed exchanged.

For all of these practical reasons, cascading Forms 1099-CAP are not a workable means to distribute information on corporate actions to downstream brokers and other nominees who need to prepare Forms 1099-CAP for the actual owners. SIA believes it is critical that the final regulations provide an effective method of distributing generic tax information to brokers and nominees. To communicate the generic tax information, the IRS could publish a list of reportable transactions based on the information provided to it by corporations on Form 8806. However, the due date for Form 8806 would need to be accelerated to enable the IRS to provide a timely publication. We recommend a due date of the 30th day after the effective date of the transaction or December 31, if earlier. A listing of reportable corporate actions would serve a function similar to that of the current IRS Publication 1212, *List of Original Issue Discount Obligations*. This publication helps brokers and other middlemen identify publicly offered original issue discount (OID) debt instruments that they may hold as nominees for the true owners and the daily rate of OID accrual, so that they can prepare Forms 1099-OID as required. Information is reported to the IRS by issuers on Forms 8281 and the IRS provides the necessary information in the publication by CUSIP (Committee on Uniform Securities Identification Procedures) number. A CUSIP is a nine-character number that uniquely identifies a particular security and is used in trading and clearing the security. Similarly, a publication on corporate actions could be issued to identify the reportable transactions and provide the per share amounts of taxable consideration. Such a publication would benefit the IRS by placing all brokers and nominees on notice of the reportable transactions and creating a uniform standard of compliance.

Alternatively, the IRS could create a directory of corporate actions similar to Publication 938, *Real Estate Mortgage Investment Conduits (REMICs) Reporting Information and Other Collateralized Debt Obligations (CDOs)*. This publication provides the name and telephone number of the REMIC/CDO representative from whom a broker, middleman or a taxpayer may request generic tax information and identifies the REMIC/CDO securities by CUSIP number. A similar system of providing the issuer name and contact information for each security actually or deemed exchanged (by CUSIP number) is necessary for brokers to identify reportable corporate actions. The IRS should require the corporations to provide the necessary tax information on a per share basis to anyone who may inquire, even if they are not holders of record on the books of the corporation. Eligible requesters should include stock exchanges, clearing organizations, dividend announcement services and other vendors who are in the business of providing information on corporate actions to the market participants.

If the IRS decides not to issue a publication, we believe that the IRS should require corporations to furnish generic tax information to all holders of record that are exempt recipients, including clearing organizations, securities depositories, their nominees and brokers. Due to the difficulty of independently identifying reportable transactions, the distribution of generic tax information to these organizations should not be conditioned upon their making an information request but rather the distribution by corporations should be made mandatory. Since these recipient organizations are not taxpayers, there is no need for a corporation to furnish a Form 1099-CAP to them. Consistent with the usual information reporting schemes, these organizations should be treated as exempt recipients in the final regulations. The role of these organizations would be solely that of a conduit or an agent for distributing the generic tax information to brokers (including banks) that hold the securities for the actual owners, as they can be expected to do in the ordinary course of their business. This should help ensure that information regarding these corporate actions is disseminated widely and timely. This is similar to transition year procedure described in Announcement 2003-7 and to the permanent procedure for furnishing generic tax information on REMICs and CDOs to brokers and other persons. See Reg. §1.6049-7(e). *The proposed procedure would utilize existing processes for distributing information and therefore would minimize the cost of implementation and the transition period for the industry.* The letter or notice provided by the corporation should include the minimum information that a broker or bank would need to prepare a Form 1099-CAP for shareholders, including a description of the transaction, its effective date, the CUSIP numbers for both the old and the new securities, and the fair market value of any taxable consideration and the federal income tax consequences of the transaction to U.S. investors.

II. Brokers should be allowed to furnish Form 1099-B in lieu of Form 1099-CAP to the actual owners of stock.

Although not specifically required under section 6045, many brokers currently furnish information on Forms 1099-B to the actual owner showing the fair market value of the new securities received in taxable corporate actions. To instead report these transactions on Forms 1099-CAP would require these firms to undertake a major systems effort to re-write programs used to create the year-end consolidated payee statements, reconcile monthly statements and prepare the electronic or magnetic media files for submission to the IRS. In addition, the IRS would need to publish the format and filing specifications for Form 1099-CAP no later than the end of the second quarter of 2003 to provide sufficient time for brokers to complete the necessary computer programming. Otherwise, brokers likely will not be able to furnish the payee statements and file the information returns by their respective due dates.

A new form also could create a great deal of confusion for taxpayers with little benefit to the IRS. Confusion is likely to arise from split reporting on corporate actions, with in kind payments reported on Form 1099-CAP and cash payments reported on Form 1099-B. Taxpayers may not recognize that the two different types of Form 1099 relate to parts of the same transaction. We request either that (1) the definition of sale in section 6045 be amended to require reporting of the fair market value of taxable property (and not just the cash) received in a corporate action on Form 1099-B or (2) the final regulations permit brokers to satisfy their reporting obligations on corporate actions by reporting these transactions on Form 1099-B instead of Form 1099-CAP. The instructions to Form 1099-B for 2003 should also be clarified to indicate that a broker may furnish Form 1099-B, in lieu of Form 1099-CAP, for both the amount of cash and the value of taxable property received in a corporate action.

III. Brokers should be allowed to report the cash and the fair market value amounts either as a single transaction or as separate transactions.

Most brokers book payments made in cash and in kind separately, even though both types of consideration are received in exchange for the same security. Due to these processing and systems limitations, some brokers cannot readily combine the amounts of cash and fair market values of property into a single reportable transaction. Rather, these brokers need to report the amounts of cash and the fair market values of property as separate transactions on the same type of information return. The taxpayer should be able to easily identify all transactions relating to a taxable corporate event, whether cash, property or both, since many brokers list sale and exchange transactions individually in a combined Form 1099-B. We therefore request that the final regulations permit either combined or separate reporting of taxable consideration received in corporate actions.

IV. The IRS should permit payers to combine Form 1099-CAP with Forms 1099-B, 1099-DIV, 1099-INT, 1099-OID and 1099-MISC (royalties) in a consolidated payee statement.

Many brokers currently combine Forms 1099-B, 1099-DIV, 1099-INT, 1099-OID and 1099-MISC into a consolidated payee statement, as permitted by the annual revenue procedure on substitute Forms 1099. Taxpayers have found it more convenient and reliable to have all the information returns related to their account included in a consolidated tax reporting statement. Accordingly, if brokers are required or choose to report corporate actions on Form 1099-CAP, they should be permitted to combine Forms 1099-CAP with these other types of information returns. The annual revenue procedure on substitute forms should be amended to clarify this matter.

V. Form 1099-CAP for 2003.

The IRS recently published Form 1099-CAP for 2003 and instructions to the form. We note that much of the information reportable on Form 1099-CAP is the same type of information that would otherwise be reported by brokers on Form 1099-B respecting taxable sales or exchanges. With some modification of the information requirements for Form 1099-CAP, brokers could use Form 1099-B as a readily available substitute. The separate boxes (boxes 3, 8 and 9) on Form 1099-CAP for the cash, the fair market value of stock and the fair market value of other property received by the shareholder could be combined into one entry and reported as gross proceeds in box 2 of Form 1099-B or separate Forms 1099-B could be prepared for each type of consideration. On Form 1099-B the field containing the description of the security sold or exchanged (box 5) should cover sufficiently the descriptive items reportable on Form 1099-CAP: the number of shares (box 5), the class of stock (box 7) and the name of the corporation (box 10). However, since the security description provided by a broker on Form 1099-B may or may not include the number of shares exchanged, this information should be made optional. Further, since a broker is unlikely to know the EIN of the reporting corporation and the taxpayer does not need it, we request that this reporting requirement be eliminated.

The check box on Form 1099-CAP for indicating when no loss may be recognized is a useful communication tool for taxpayers. It could be added to Form 1099-B to serve the same purpose. In addition, instructions to the Recipient should be provided on whether or how to present loss transactions on the taxpayer's federal income tax return. If a loss transaction must be shown on Schedule D to Form 1040 to avoid a controversy with the IRS, then taxpayers should be instructed on how to zero out the amounts reported on the information return.

VI. Backup Withholding Should Not Apply to Payments in Kind

The Proposed Regulations do not contain provisions on how backup withholding is to apply to corporate actions. However, the Form 1099-CAP for 2003 contains a box for Federal income tax withheld (box 4) and the instructions state that a broker must backup withhold at a 30 percent rate if the taxpayer did not furnish a taxpayer identification number. First, actual owners who receive payments directly from a corporation or its paying agent should be treated the same as those who receive payments from brokers. Second, we recommend that backup withholding not apply to payments made in kind. The actual owner may not have sufficient cash in his account to satisfy the backup withholding. Further, the broker or other payor may not be able to readily sell the property exchanged due to legal or market constraints. These matters should be clarified in the final regulations.

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Thank you for your consideration of our views. We welcome the opportunity to work with the IRS to develop workable solutions for tax reporting that avoid unnecessary burdens on the reporting community. If you have any questions or wish to discuss this matter further, please do not hesitate to contact Patricia McClanahan, SIA's Vice President and Director for Tax Policy, at (202) 326-5324.

Very truly yours,

Nicole Tanguy, Chair
SIA's Committee on Tax Compliance
and Administration