



Securities Industry Association

1401 Eye Street, NW • Washington, DC 20005-2225 (202) 296-9410 • Fax (202) 296-9775 •
www.sia.com, info@sia.com

June 27, 2002

The Honorable Pam Olson
Acting Assistant Secretary (Tax Policy)
Main Treasury Building
1500 Pennsylvania Avenue, N.W.
Washington, DC

Dear Ms. Olson:

I am writing on behalf of the members of the Securities Industry Association ("SIA")¹ to request your assistance in remedying a long-standing defect in the tax reporting system. Specifically, SIA would like to enlist your help this year in seeking legislation to provide securities firms and others who hold investments as nominees on behalf of customers in the ordinary course of their business with an additional two weeks, until February 15, to report all required tax information to their customers.² For well over a decade, requiring nominees to meet the existing January 31 due date has caused needless errors and paperwork burdens for taxpayers, businesses and the Internal Revenue Service.

SIA estimates that this "good government" change would reduce by *at least two-thirds* the number of initial Forms 1099 sent by securities firms to their customers that must later be corrected. This would appreciably simplify tax compliance for taxpayer-investors, protect the public's confidence in the accuracy of the tax information reporting system, and result in fairer administration of the tax laws.

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>.)

² Under this proposal, the January 31 due date would be retained for issuers (e.g., corporations, mutual funds and REITs) making payments on their own stock, and for banks and credit unions paying interest on their customers' deposits. In addition, securities firms would continue to be required to meet the January 31 due date for tax reporting obligations to employees and vendors (or such other due date as is currently applicable for certain other payments.)

How the current rules produce many unavoidable errors in initial tax information provided to taxpayer-investors. Securities firms typically hold individual corporate stocks, bonds, mutual fund shares, interests in real estate investment trusts (REITs), and other securities as nominees on behalf of their customers. When securities firms as nominees receive and then pay on to their customers the dividends, interest income, and other amounts relating to their investment accounts, they are required to provide their customers with IRS Forms 1099 reporting these amounts by January 31 of the year following payment. Due to widespread customer demand, many securities firms now provide all tax information to their customers at one time on a consolidated statement permitted by the IRS.

Each year a percentage of initial IRS Forms 1099 provided by securities firms to their customers (roughly 5-8 percent) must be reissued after a securities firm is advised that the information included on an original Form 1099 is no longer correct. Although the error rate is typically modest, this amounts to a very large number of Forms 1099 annually that require correction. This is despite extensive work each year by securities firms in cooperation with issuers, the mutual fund and REIT industries, and third party service providers to eliminate tax reporting errors.

The single largest source of error in Forms 1099 issued by securities firms is one that securities firms can do very little to change, irrespective of the resources committed. It results from rules in the Internal Revenue Code that effectively prevent mutual funds and REITs from ascertaining with certainty - - *until after year end* - - the character of their distributions relating to the prior year. These distributions consist of capital gain dividends, ordinary dividends, exempt-interest dividends, and returns of capital, depending on the particular mutual fund or REIT, and their characterization affects whether or not, and how, the amounts need to be reported by securities firms to their customers. Securities firms are completely dependent upon mutual funds and REITs as originators of this information to provide them with correct information. However, mutual funds and REITs themselves are under severe time pressures to get the information correct on a timely basis and, in any event, have no legal obligation to supply securities firms with the tax information until January 31. Thus, it is inevitable that some of the original information from mutual funds and REITs that securities firms must send out to customers by January 31 turns out to be wrong and in need of correction.

Additional sources of errors grow out of the large number of complex tasks that must be dealt with in the very compressed period of time available. Information reporting is simply much more demanding than it was when originally conceived decades ago. For example, in contrast to the reporting of simple interest and dividend payments, many intricate rules impact the proper reporting with respect to mutual funds, REITs, unit investment trusts, corporate

reorganizations, securities with original issue discount (OID), innovative financial instruments, and other items. Further, a typical securities firm must provide Forms 1099 with respect to the full range of investments and transactions, whereas most others responsible for tax reporting must contend with a much more limited number of types of payments and events.

Finally, the very limited one-month time frame in which to complete tax reporting is inevitably compressed even further by the sheer volume of Forms 1099 that must be provided to customers. Data input must be largely shut down at least a week before the end of January (earlier for the largest firms) in order to allow time for printing the millions of paper Forms 1099 and preparing them for mailing.

Treasury study mandated by Congress in 1998. The industry for many years has sought legislation to remedy the problem of unavoidable reporting errors and corrections. In the IRS Restructuring and Reform Act of 1998, Congress mandated that Treasury study a proposal (much broader than what SIA now proposes) to extend from January 31 to February 15 the due date for providing all tax information returns to taxpayers (except for Forms W-2). This study was due by June 30, 1999, but has not been issued.

Benefits to taxpayers and tax administrators. Providing securities firms and other nominees with an additional two weeks in which to fulfill all tax reporting obligations to customers would dramatically reduce the number of incorrect Forms 1099 sent by securities firms to their customers. *It is SIA's estimate that at least two-thirds of the corrections that now occur would no longer be required following this change.*

Taxpayer-investors would benefit from the change because erroneous information can cause confusion and make it more time consuming and costly to complete their tax returns accurately. Worse, mistakes on Forms 1099 lead some taxpayers to file inaccurate tax returns, often resulting in tax overpayments. These taxpayers then face the unattractive alternatives of going to the time and expense of amending their original tax returns or ignoring their tax overpayments. Even those taxpayers that receive information ultimately proven to be correct may be in doubt that it is correct for some time following receipt. This is because some securities dealers feel compelled to advise their customers to delay filing their tax returns for a limited period of time in order to allow time for receipt of corrected Forms 1099.

The IRS also would benefit from providing an additional two weeks to securities firms and other nominees. The status quo is bad for tax administration generally because it undermines taxpayers' confidence in year-end tax reporting. In addition, it produces additional work for the IRS to the extent that there are corrected Forms 1099 to process and more taxpayers filing amended returns. Finally, the current rules result in unfair or uneven administration of the tax laws

to the extent that taxpayers (i) overpay their taxes by an amount that does not justify the time or expense of filing an amended return or (ii) underpay their taxes and fail to amend their tax returns.

Comprehensive extension for nominees necessary to allow consolidated tax reporting to investors. For very practical reasons, the two-week due date extension should be provided with respect to all types of amounts that securities firms must report to their customers, not just those payments that securities firms make as nominees. Securities firms typically make the vast majority of their payments to customers in their capacity as nominees. Further, today a very large percentage of securities firms' customers invest in mutual funds and/or REITs, the very investments that are most likely to lead to amended Forms 1099. A uniform due date for all amounts reported to customers would permit those securities firms that provide all tax information to customers on one consolidated statement to continue to provide this service to customers. Both taxpayer-investors and the IRS would benefit from the reduced likelihood of errors resulting from such consolidated statements.

No policy goal would be served by requiring securities firms to meet an earlier deadline with respect to their "non-nominee" payments, because the vast majority of their customers (*i.e.*, those also receiving nominee payments with respect to their brokerage account) would get no benefit from early receipt of only a portion of their tax information. Further, such a requirement would create a risk that some taxpayers would mistake the earlier statement for a complete statement of all of their tax information for the year.

No adverse impact on early tax return filers. The proposal would limit the due date extension to those who truly need it to prepare accurate Forms 1099: securities firms and other nominees who must rely on others who themselves have until January 31 to provide nominees with information. The targeted nature of the extension would ensure that those with simple tax returns (*e.g.*, those receiving interest income on a bank or credit union account) would continue to have their Forms 1099 delivered by January 31, enabling them to file their returns early. Further, those with more complex investments *should not* file their tax returns early, because doing so could lead a significant number of them to file inaccurate tax returns.

* * * * *

This tax reporting problem has been brought to my attention regularly over the years by both large and small SIA member firms as causing considerable confusion for investors and unnecessary business disruptions for firms. Addressing this issue this year would immediately and appreciably reduce taxpayer and business compliance burdens, resulting in significant time and cost savings. The proposed change to the tax laws could be done at no revenue cost, and free up resources within the IRS to the benefit of tax administration. I hope

that the Treasury Department will work with us on our proposal and actively support our industry effort to obtain legislation without delay to end the annual cycles of unavoidable errors and corrections in year-end tax reporting.

Thank you for your attention to this matter. I look forward to working with you on this, and urge you to call me or Patti McClanahan, SIA's Vice President and Director for Tax Policy (202-326-5324), to discuss this further. With best wishes, I am

Sincerely yours,

Marc Lackritz
President
Securities Industry Association

Cc: Eric Solomon
Rob Hanson
Dave Robison
Grete Carro
Terry Lutz