



February 14, 2012

**Via Electronic Delivery**

Ms. Pamela Lew  
Office of Associate Chief Counsel (Financial Institutions and Products)  
CC:PA:LPD:PR (REG-102988-11)  
Room 5203  
Internal Revenue Service  
P.O. Box 7604, Ben Franklin Station,  
Washington, DC 20044

**Re: Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options [REG-102988-11]**

Dear Ms. Lew:

The Securities Industry and Financial Markets Association (SIFMA)<sup>1</sup> respectfully requests that the IRS promptly exercise its authority to extend the effective dates for basis reporting on debt instruments and options.<sup>2</sup> For information reporting on options, SIFMA suggests that the rules become effective no earlier than January 1, 2014. For basis reporting on debt instruments, SIFMA suggests that the rules become effective no earlier than January 1, 2015. These effective dates assume the relevant provisions in final regulations are issued no later than 18 months before the applicable effective date.

SIFMA appreciates that the IRS has provided proposed regulations on debt instrument and options reporting that respond to many of the concerns initially voiced by the brokerage industry. Some SIFMA members currently provide a sophisticated level of adjusted basis reporting on debt instruments and options as a customer service. Some SIFMA members provide limited or no basis information for debt instruments and options to customers. SIFMA members at both ends of the spectrum understand the value

---

<sup>1</sup> The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> As an alternative to an extended effective date, SIFMA would request penalty relief.

that taxpayers and the IRS are expected to receive from 1099 reporting that includes basis reporting on debt instruments and options.

In this letter, we will explain the major obstacles that brokers face in implementing the proposed reporting rules for options and debt instruments. We believe these obstacles, when viewed in context, provide a strong case for deferred effective dates. The sooner the IRS provides notice of deferred effective dates, the sooner brokers will be able to effectively allocate resources to competing regulatory requirements.

SIFMA will submit additional comments that provide detailed explanations of specific technical issues that brokers believe the Treasury and IRS need to address to enable brokers to implement the rules for debt instruments and options. In addition, SIFMA members would welcome the opportunity to meet with IRS staff members to address any questions the IRS may have and to engage in a dialogue on how these rules can be implemented effectively and efficiently.

Our hope is that deferred effective dates will allow the IRS and brokers to work through these issues together, producing final regulations that meet IRS goals without unduly burdening the brokerage industry.

#### 1. In a Sea of New Rules, Prioritizing Makes Sense

A number of new and complex tax reporting, withholding, and documentation rules are scheduled to come into effect beginning in 2013. When looking at what can be done over the remaining 10 months of 2012, we believe it is appropriate for the IRS to prioritize implementation of those rules that have the most meaningful policy or revenue implications.

- The recent issuance of proposed FATCA regulations will require brokers to devote significant resources in 2012 to begin programming and operations changes required for FATCA compliance.
- Recently released Section 871(m) regulations will require brokers to put into place new rules for classifying and withholding on instruments that are “specified notional principal contracts.”
- A number of tax provisions are now scheduled to sunset in 2013. Whether these provisions sunset as scheduled, are extended, or are altered, brokers will be required to devote resources to reflect the result. Congress also may enact new measures that will affect brokers. Any change to the content or format of the annual package of Forms 1099 to be sent to account holders requires input from systems and design teams. Extensive testing of such changes is required well in advance of year-end to ensure accurate and timely production of such forms in early 2013.

- The technology and operations teams at brokerage firms will be devoting significant resources over the remaining 10 months of 2012 to finish the technology and operations upgrades required to comply with the basis reporting rules that became effective for the 2012 tax year.
  - The transfer statement rules are proving to be especially challenging to implement in a cost-effective manner. For example, cost basis received through manual transfer statements must be manually entered on our systems, which requires additional headcount to perform the task. As another example, there is no central resource available for brokers to obtain accurate mailing addresses for the proper department at the receiving brokerage firms, resulting in many paper transfer statements being returned to the transferring broker.
- The 2006 Government Accountability Office (GAO) report<sup>3</sup> noted that, of all taxpayers who misreported securities sales, 97 percent of such taxpayers misreported gains and losses from sales of stocks and mutual funds. Only an estimated 5 percent of those who misreported securities sales were found to have misreported bonds, options or futures.
  - By implementing basis reporting on stocks and mutual funds, brokers are already providing the IRS with the information required to address the vast majority of misreported securities sales. Requiring brokers to implement additional reporting on options and debt instruments in 2013 will place a large and unwarranted burden on brokers.

For the remainder of 2012, brokers should not be deterred from focusing on addressing those reporting and withholding requirements that have more important policy and revenue implications than the proposed additional reporting on options and debt instruments.

## 2. Pressure on Available Technology Resources Poses Risk of Poor Implementation

For the brokerage industry to provide the additional reporting for options and debt instruments, significant technology and operational development lies ahead. A substantial amount of human capital will be required to implement the new reporting rules and the associated upgrades to customer interfaces. SIFMA members' goal is to provide a smooth, streamlined process for their customers and the IRS.

Given the current pressure on development resources, our members are deeply concerned they will not meet this goal if brokers are required to provide additional reporting on options and debt instruments in 2013.

---

<sup>3</sup> Government Accountability Office, 'Capital Gains Tax Gap: Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed,' June 13, 2006 (GAO-06-603).

- *There is limited expertise that can be tapped.* There are a limited number of qualified computer programmers and tax compliance professionals who can support this type of work. Every broker and cost basis service provider is competing for the same small pool of talent.
- *Available personnel cannot be spared in 2012.* The qualified professionals who could be assigned to projects related to options and debt instruments are the same personnel who are qualified to undertake implementation of FATCA and other new withholding and reporting requirements as outlined in the preceding section of this letter.
- *Integration of basis reporting systems with tax reporting systems has placed additional pressure on human resources.* The interaction between cost basis accounting systems and tax reporting systems increases the complexity of maintaining, upgrading and coordinating both systems.
- *Significant upgrades to customer-facing systems have been required to assure we are communicating effectively with customers.* For example, brokerage firms have undertaken significant technology and interface improvements to allow customers to change eligible positions back and forth between the cost basis method and the average basis method.
- *“Code contention” makes it impossible to speed up key deliverables.* The “engines” of code that drive basis reporting systems typically can be worked on by only one person at a time. Adding headcount cannot expedite much of the technology work required to implement the reporting rules for options and debt instruments.

SIFMA would be happy to facilitate conversations between technology and operations personnel of SIFMA members and the IRS. If the technical aspects of brokers’ resource constraints are well understood before the IRS issues final regulations, the IRS can craft final regulations that meet the needs of the IRS without placing undue stress on development resources during the remainder of 2012.

### 3. Taxpayers (and Return Preparers) Need Time to Catch Up

SIFMA members have reported signs of customer confusion over the implementation of the current basis reporting rules.

- More than one leading brokerage firm that is a member of SIFMA has deployed additional personnel to handle the increase in customer inquiries related to existing basis reporting rules.

- Another major brokerage firm that is a member of SIFMA has reported a year-over-year increase in January call volumes of 132 percent and an increase of 206 percent in service requests. These increases appear to be largely the result of the new basis reporting rules reflected on their 2011 Forms 1099. Other firms have reported similar increases over the past two years since these rules became effective.
- The 2011 release of Form 8949 is a big change for brokerage account holders and their return preparers. SIFMA members have spent considerable time and money revising website “help” sections and other customer-facing publications to help customers navigate the new Form 1099 format and how it ties into the new Form 8949.
- Many individual account holders who hold mutual fund positions (and their return preparers) will face an additional learning curve for the 2012 tax year. Account holders with average basis positions will be subject to new rules regarding how to elect average basis, how to revoke an average basis election (or opt out of a broker’s default average basis method), and how to calculate separate averages for shares that are deemed held in separate accounts even though they are part of the same investment position held at the same brokerage firm.
- The requirement to code many share transfers as gifts has caused confusion and consternation for both individual account holders and institutional clients classified as partnerships.
- Many account holders are confused and angry when they find out that 1099 reporting will not reflect a specific tax lot identification made after the transaction has settled (or, if applicable, the time of settlement required under the securities laws).

Based on what we have seen so far in 2012, we expect enormous customer pressure to continue to provide higher levels of service in helping customers navigate these new rules, particularly in 2012.

4. A Deferred Effective Date Offers Opportunity for Further Productive Collaboration Between IRS and Industry.

The IRS and brokerage industry have had an encouraging amount of successful collaboration leading up to the issuance of the proposed regulations for basis reporting on debt instruments. We believe the complexity of reporting for options and debt instruments (and the associated transfer reporting) warrants extending the time allowed for brokers to work with the IRS toward the shared goal of a smooth implementation.

- The systems currently in use for transferring securities between brokers typically deliver the original cost of a debt instrument. A broker who currently provides adjusted tax basis information for debt instruments would take the original cost and acquisition date and apply its own amortization or accretion calculation, as applicable. A broker receiving adjusted basis information is not able to apply the methods in the proposed regulations to further adjust the basis received from the transferor because: the existing calculation methods key off of original cost.
  - To comply with the existing proposed regulations, brokerage transfer systems across the industry would require a major (and highly costly) rewrite. By deferring the effective date, IRS would have the opportunity to work with industry participants to structure the transfer reporting requirements in a way that allows for accurate processing and transfers without major overhaul of existing systems.
- Open questions related to additional reporting on options and debt instruments remain to be resolved before actionable IRS guidance can be issued. The proposed regulations on basis reporting for options and debt instruments are an excellent start. Substantially more detailed rules are required, however, to begin the programming and systems work required to implement additional reporting on options and debt instruments. Deferred effective dates for these reporting obligations will give the IRS time to work with brokers to develop a comprehensive, clear set of rules that can be readily translated into system design requirements and technology specifications.

## 5. Conclusion

IRS and SIFMA members' goals are well-aligned with respect to reporting on options and debt instruments. The IRS wants to receive accurate basis information and provide a good experience for taxpayers. Brokers want to provide a smooth experience for their customers. Both the IRS and brokers face significant challenges in meeting these goals with respect to reporting on debt instruments and options.

Rushing toward the finish line increases the risks of ambiguity in the final regulations and insufficient testing of the complex systems necessary to implement their requirements. We respectfully recommend that efforts to comply with the rules implementing FATCA, IRC § 871(m) and the currently effective basis reporting rules should receive priority in 2012. A deferred effective date for additional reporting on options and debt instruments will allow the IRS and the brokerage industry to address competing priorities in a methodical, thoughtful manner that will provide the best result for taxpayers.

If you have any questions or need more information, please do not hesitate to contact me at (202) 962-7333 or by email at [ppeabody@sifma.org](mailto:ppeabody@sifma.org).

Sincerely,

A handwritten signature in blue ink that reads "Payson Peabody". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Payson Peabody  
Managing Director and Tax Counsel  
Securities Industry and Financial Markets Association

Cc:

Ms. Emily McMahon  
Acting Assistant Secretary for Tax Policy  
U.S. Department of Treasury

Ms. Catherine Barre  
Office of Deputy Commissioner for Services and Enforcement  
Internal Revenue Service