April 5, 2016

Pamela Lew
Office of the Associate Chief Counsel
Financial Institutions & Products
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20024
Pamela.lew@irscounsel.treas.gov

Re: Comments on Complex Debt Reporting Requirements.

Dear Ms. Lew,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide comments to the Internal Revenue Service ("IRS") regarding the reporting requirements for complex debt. We are concerned that calculation of basis for complex debt instruments will be inconsistent, difficult, or even impossible based on the information broker dealers have access to today. We have greatly appreciated your attention to our concerns and questions relating to various cost basis reporting issues in the past, and for the opportunity to provide additional feedback.

As described in greater detail in the chart accompanying this letter, SIFMA members are concerned that the existing rules do not enable accurate and consistent reporting of basis on complex debt instruments to the IRS, to clients, or to receiving brokerage firms under a transfer statement. In many cases, vital information to perform reportable basis calculations is difficult to obtain or entirely unavailable. In addition, the current transfer statement rules do not always provide for the transmission of critical data, leaving a receiving broker unable to perform

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. 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.

calculations that are consistent with prior reporting. In addition, several of the complex debt regimes require holders to make certain determinations and allocations with respect to the debt, but there are no rules that require holders to inform brokers of those holder-level decisions.[2] It would be helpful if there were safe harbors that allowed brokers to perform calculations using assumptions, or to defer the effective date for such reporting until this issue can be resolved. Ensuring accurate and consistent reporting by brokers is a shared goal of our membership; therefore, SIFMA respectfully requests that the IRS consider providing exemptions from broker reporting obligations, safe harbors to facilitate compliance, and a reasonable delay in the effective date for reporting on certain complex debt instruments until more detailed regulations can be promulgated.

Specifically, in light of the examples and difficulties outlined in the attached chart, SIFMA respectfully requests that the IRS: (a) allow brokers to treat any debt instrument, whether complex or simple debt, as exempt from basis reporting if, after a good faith effort, the broker is unable to obtain information necessary to calculate proper accounting for the debt instrument, whether because the prospectus, reliable third-party data, or complete information on a transfer statement is not readily available, (b) provide a safe harbor that will allow brokers to rely on any issuer disclosure regarding tax treatment contained in the relevant offering documents, and (c) delay the effective date for broker basis reporting for complex debt where necessary until the IRS can promulgate new regulations that will (i) expand the data delivered under a transfer statement between brokers and (ii) provide for default assumptions that would allow broker reporting to be both accurate, comprehensive, and consistent.

Brokers are able to fulfill their reporting obligations only where the information necessary to calculate accruals on, or properly characterize the tax treatment of, a security is available. Clarifying the rules to confirm that, in the absence of clear data to support those accruals or treatment, a broker is not required to treat a security as a covered security will ensure that the reporting made to taxpayers and to the IRS is accurate and consistent. We believe this will benefit both taxpayers and the IRS.

---

[2] For example, Treas. Reg. Sec. 1.1275-4(b)(9)(i) requires purchasers of a contingent payment debt instrument reasonably to allocate the difference between basis and adjusted issue price to daily portions of interest or projected payments. These holder-level adjustments affect both the calculation of OID on the instrument and the holder's adjusted basis. Brokers generally have no information about such adjustments, and may not be able to perform accurate basis or income calculations as a result.

We appreciate the IRS's continued work relating to cost basis reporting requirements and consideration of our additional questions. The attached chart addresses a number of technical issues our member firms are confronting with respect to complex debt reporting and makes recommendations for guidance. We would like an opportunity to discuss these issues and our recommendations at your convenience. Please do not hesitate to contact me or Jillian Enoch at (202) 962-7300.

Sincerely,

Payson R Peabody

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

Debt Instrument	Information/Argument	Recommendation
Debt instrument that provides for more than one rate of stated interest (including a debt instrument that provides for stepped interest rates)	Calculating basis on stepped interest rate bonds presents a unique challenge for brokers. As noted in the Wolters Kluwer letter to the IRS dated August 20, 2015 (the "Wolters Kluwer Letter"), some issuers are treating all interest on these instruments as OID rather than treating a portion of the interest payments as QSI and the rest as OID. Furthermore, only a fraction of stepped rate bonds are listed in Pub 1212. This creates problems for brokers who are required to perform basis calculations and make required reportings.	SIFMA requests the IRS provide penalty relief for brokers that provide incorrect reporting or fail to make required reportings where the issuer has provided incorrect information or where information is not available.
Convertible debt instrument	A wide range of securities are classified as convertible debt, complicating the tax consequences and subsequent calculation of basis. As noted in the Wolters Kluwer Letter, "Like variable rate debt, convertible debt is a broad classification of securities by market reference data vendors. Similarly, the classification of a security as convertible debt does not address the tax classification of the instrument. Some constitute classic convertible instruments that are fixed rate debt convertible into stock of the issuer of the debt. Some constitute CPDIs. Others constitute derivatives or investment units." Furthermore, events and actions, including under Section 305(c) can affect conversions and impact the basis calculations, but those events are not reliably reported by issuers on Form 8937. As explained in detail in the Wolters Kluwer Letter, "The lack of available data providing this tax information makes OID and basis calculations for convertibles burdensome for brokers and creates risk of broker-to-broker and taxpayer inconsistent reporting." In addition, the treatment of market discount on convertible debt can lead to some complications. If a holder has not elected to take market discount into income currently, accrued market discount at the time of conversion will "attach" to the shares received.[1] The market discount would be recognized, to the extent of gain, on a subsequent disposition of the equity.[2] Not all brokers' systems can track market discount on equity, nor is market discount information supplied on a transfer statement for equity.[3]	SIFMA requests the IRS delay the reporting requirement for convertible debt instruments until additional guidance can be issued clarifying the information issuers are required to provide in order for brokers to perform basis calculations. Absent a delay, we respectfully request a safe harbor for brokers to treat convertible debt as non-covered in those instances where insufficient information is available to perform basis calculations.
Variable rate debt instruments (VRDI)	Variable rate debt instruments are subject to a number of requirements, including that for example, a qualified floating rate be "reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds"[4] or that an objective rate not be reasonably expected to be front- or back-loaded.[5] Failing qualification as a VRDI, a debt instrument	SIFMA requests the IRS provide penalty relief for brokers that provide incorrect reporting or fail to make required reportings where information is not

[1] *See* Section 1276(c)(2)(B).
[2] *See* Committee Reports for S. 98-169, P.L.98-369.
[3] Treas. Reg. Sec. 1.6045A-1(b)(1).
[4] Treas. Reg. Sec. 1.1275-5(b)(1).
[5] Treas. Reg. Sec. 1.1275-5(c)(4).

	would revert to CPDI treatment. [6] These determinations are highly fact specific, and brokers are not positioned to make any independent assessments of the status of a debt instrument as a VRDI versus a CPDI. Calculation of OID for a VRDI with multiple rates (*i.e.*, VRDIs not subject to Treas. Reg. Sec. 1.1275-5(e)(2)) requires construction of a "fixed rate substitute" for each floating rate.[7] In addition, calculation of OID for a VRDI with a fixed rate requires identification of a substitute debt instrument paying only floating rates that would be approximately the same fair market value as the VRDI in question as a preliminary step before identifying "fixed rate substitutes."[8] Brokers are not in a position to undertake this analysis, but the calculation of OID will impact basis. In addition, there is no mechanism for brokers to transfer information on the fixed rate substitute to a receiving broker. In addition, while the regulations require adjustment of QSI to reflect shortfalls in the actual floating coupons paid versus the "assumed" rates based on the fixed rate substitutes[9], the regulations do provide rules to address scenarios where the shortfall exceeds the amount of QSI in a given period; while the CPDI rules, for instance, allow holders to take an ordinary loss (to the extent of prior unreversed OID), and thereafter carry excess negative adjustments, no such rules exist in the VRDI regime, nor are there any rules to provide for coordination between transferring and receiving brokers with respect to these suspended adjustments. Furthermore, SIFMA would like to echo the additional questions and concerns raised in the Wolters Kluwer Letter regarding the challenges with VRDI.	available or where the issuer has provided incorrect information. Brokers are not in a position to make these kinds of determinations, and SIFMA respectfully requests that the IRS establish a safe harbor that entitles brokers to rely on the issuer's disclosure in its offering documents when classifying a debt instrument.
Inflation-indexed debt instruments	Deflation adjustments -- and bond premium treated as deflation adjustments under Treas. Reg. Sec. 1.171-3(b) -- offset interest otherwise includable on the instrument.[10] Additionally, deflation adjustments reduce basis as they offset income (OID, QSI and market discount).[11] To the extent that deflation adjustments exceed cumulative income inclusions on the note (as adjusted for prior periods' deflation adjustments), that excess must be carried forward.[12] There is no mechanism for a broker to transfer information about carried over deflation	SIFMA requests the IRS delay the reporting requirement for convertible debt instruments until additional guidance can be issued expanding the required CBRS fields to include deflation adjustments.

[6] Treas. Reg. Sec. 1.1275-5(a)(1).
[7] Treas. Reg. Sec. 1.1275-5(e)(3).
[8] Treas. Reg. Sec. 1.1275-5(e)(4).
[9] Treas. Reg. Sec. 1.1275-5(e)(3)(iv).
[10] Treas. Reg. Sec. 1.1275-7(f)(1)(i).
[11] Treas. Reg. Sec. 1.1275-7(f)(2).
[12] Treas. Reg. Sec. 1.1275-7(f)(1).

	adjustments to a receiving broker. It cannot be guaranteed that, absent regulation requiring this information, a delivering firm would include the necessary data.	Absent a delay, we respectfully request a safe harbor in those instances where insufficient information is provided necessary to perform the calculation.
Contingent payment debt instruments (CPDI)	Treas. Reg. Sec. 1.1275-4(b)(6)(iii)(C) requires net negative adjustments (*e.g.*, net annual shortfalls of actual versus projected contingent payments) to be carried over to future periods if the amount of those adjustments exceeds cumulative income inclusions on the CPDI (as adjusted for prior periods' net negative adjustments). Brokers are not required to deliver a running account of carried over negative adjustments or unreversed OID to a receiving broker on a transfer statement. The receiving broker will need that information, however, to report future OID and income/loss in connection with a disposition.[13] While gain/loss is typically ordinary on a CPDI (see, e.g., Treas. Reg. Sec. 1.1275-4(b)(8)(i-ii)), Treas. Reg. Sec. 1.1275-4(b)(8)(iii) provides for capital treatment if, at the time of disposition, there are no further contingent payments under the instrument. Brokers are not in a position to monitor whether a CPDI has additional contingent payments (*e.g.*, if a CPDI has hit a "high water mark" that fixes its payments); in addition, even if a broker had that information, it is not required to be delivered on a transfer statement.[14] Under Treas. Reg. Sec. 1.1275-4(b)(iv), if an issuer's projected payment schedule is unreasonable, the holder can create its own. Brokers are neither required nor capable of making such an independent review of the reasonableness of an issuer's projected payment schedule. Note that in cases where the holder creates their own projected payment schedule, broker reporting would necessarily be inconsistent with the holder's return. Under Treas. Reg. Sec. 1.1275-4(b)(9)(i), if basis is different from adjusted issue price, the holder must reasonably allocate the difference to the daily portion of interest or projected payments. The allocation is treated as a positive or negative adjustment—but unlike "normal" positive and negative adjustments under Treas. Reg. Sec. 1275-4(b)(6), adjustments under Treas. Reg. Sec. 1275-4(b)(9)(i) will affect basis. Brokers will not be able to report basis reflecting these holder adjustments, nor is there any mechanism for delivering the holder's allocations to a receiving broker on a transfer statement. These rules provide for a safe	SIFMA requests the IRS delay the reporting requirement for contingent payment debt instruments until additional guidance can be issued expanding the CBRS field to include net negative adjustment carryforwards and additional information about contingencies that have fixes. SIFMA requests that the IRS provide guidance stating that brokers are entitled to rely on the issuer's projected payment schedule in all cases. Additionally, we request the IRS exclude CPDIs from basis reporting if acquired at a price other than their AIP. AIP is not always reasonably accessible to brokers making it impossible to determine if the basis of the CPDI on acquisition is different from AIP.

[13] Treas. Reg. Sec. 1.6045A-1(b).
[14] Treas. Reg. Sec. 1.6045A-1(b).

	harbor for exchange-listed instruments, under which the difference between basis and AIP is ratably allocated to daily portions of interest over the remaining term of the instrument.[15] Under 1.1275-4(b)(9)(ii), if a payment becomes fixed more than 6 months prior to its payment date, it will impact the projected payment schedule, and the amount of the resulting positive or negative adjustment will impact both AIP and basis on the date the contingency fixes. Brokers are not in a position to monitor these developments, nor are they required to deliver notice of such events on transfer statements (or an updated projected payment schedule). In addition, in the event all payments fix substantially contemporaneously, the adjustments are taken into account in a reasonable manner over the period to which they relate.[16] Presumably, this is the reasonable determination of the holder—not the broker—though the regulation does not specify explicitly. Assuming this is a holder determination, the broker (or receiving broker) would not have adequate information to do basis reporting.	
Prepaid forwards	As observed in the Wolters Kluwer Letter, market participants often treat prepaid forwards as equivalent to debt for non-tax purposes, which can lead to confusion both at the client and at the broker level. SIFMA would like to echo the concern raised in the Wolters Kluwer Letter that "the lack of available data in the marketplace distinguishing [prepaid forward contracts] from debt instruments subject to cost basis reporting creates an undue burden on brokers in filtering out such securities." In addition, while the kinds of structured prepaid forwards have been available in the market for some time, there remain certain aspects of their tax treatment that are unresolved under current law. For these products, issuers generally rely on the opinion of outside counsel regarding their treatment, and deem holders, by virtue of their purchase of the instrument, to have agreed to treat the instrument consistently with the opinion of counsel. Brokers are not in a position to make any independent determinations of the tax treatment of a particular instrument, and must rely on the guidance supplied by the issuer, or the issuer's counsel, though doing so raises the risk that the IRS would reach an alternate characterization of the instrument and thus the broker would have failed to report income and basis correctly. An example of a typical disclosure, in relevant part, is provided below: <u>Example:</u> CUSIP: 06366RVH5 – Bank of Montreal, Senior Medium-Term Notes, Series C (Notes Linked to a Fixed Basket of 20 Common Equity Securities, due August 19, 2015) Pricing Supplement	SIFMA respectfully requests the IRS provide a safe harbor so that brokers are able to rely on issuer guidance, even in cases where the company notes its "intent to treat" in a certain way "unless and until such time as the Treasury Department and Internal Revenue Service determine that some other treatment is more appropriate."

[15] Treas. Reg. Sec. 1.1275-4(b)(9)(i)(E).
[16] Treas. Reg. Sec. 1.1275-4(b)(9)(ii)(G).

	US Federal Tax Considerations – 'NO STATUTORY, JUDICIAL OR ADMINISTRATIVE AUTHORITY DIRECTLY DISCUSSES HOW THE NOTES SHOULD BE TREATED FOR U.S. FEDERAL INCOME TAX PURPOSES. AS A RESULT, THE U.S. FEDERAL INCOME TAX CONSEQUENCES OF AN INVESTMENT IN THE NOTES ARE UNCERTAIN.' And; 'The Internal Revenue Service has released a notice that may affect the taxation of holders of the notes. According to the notice, the Internal Revenue Service and the Treasury Department are actively considering whether the holder of an instrument such as the notes should be required to accrue ordinary income on a current basis, and they sought taxpayer comments on the subject. It is not possible to determine what guidance they will ultimately issue, if any. It is possible, however, that under such guidance, holders of the notes will ultimately be required to accrue income currently and this could be applied on a retroactive basis. The Internal Revenue Service and the Treasury Department are also considering other relevant issues, including whether additional gain or loss from such instruments should be treated as ordinary or capital and whether the special "constructive ownership rules" of Section 1260 of the Code might be applied to such instruments. Holders are urged to consult their tax advisors concerning the significance, and the potential impact, of the above considerations. Unless stated otherwise in the relevant pricing supplement, we intend to treat the notes for U.S. federal income tax purposes in accordance with the treatment described in this pricing supplement unless and until such time as the Treasury Department and Internal Revenue Service determine that some other treatment is more appropriate.'	
Investment Units	Investment units typically trade under a single CUSIP, notwithstanding the fact that the instrument is intended to be treated as its constituent parts for federal income tax purposes. The marketplace does not provide adequate data regarding whether a security is treated as an investment unit, and, if so, what its constituent parts are. Additionally, as outlined in the Wolters Kluwer Letter, there is no "data available to assist with allocations among components" when purchased in the secondary market. Restructuring may occur which further complicates the tax consequences.	SIFMA respectfully requests the IRS exclude investment units from cost basis reporting requirements.
Debt instrument that requires payment of either interest or principal in a currency other than the U.S. dollar	Debt instruments that require payment of either interest or principal in a currency other than the U.S. dollar present a challenge for reporting brokers. These instruments have variable quotes due to the exchange rate, and also impacts the maturity price. There is a lack of information in the marketplace and prospectuses for foreign debt generally do not have all of the information required to make adequate determination of basis adjustments. These debt instruments are further complicated due to the exchange rate.	SIFMA requests the IRS provide a safe harbor in those instances where brokers are unable to obtain a quote for the security.

Debt instrument that, at one or more times in the future, entitles a holder to a tax credit	Debt instruments that, at one or more times in the future, entitle a holder to a tax credit, create difficulties for brokers obtaining information to report basis calculations. Final guidance is needed concerning stripping transactions for qualified tax credit bonds under section 54A of the Internal Revenue Code, and certain income tax accounting matters associated with holding and stripping these bonds.[17] Absent additional guidance clarifying how to report or adjust proceeds and basis for tax credit bonds, brokers are unable to provide accurate reporting.	SIFMA requests that IRS provide penalty relief for reporting of these debt instruments until final regulations are issued that clarify the reporting.
Debt instrument that provides for a payment-in-kind (PIK) feature	Under Treasury Regulation 1.1275-2(c)(3), Payment in Kind ("PIK") bonds are securities providing the issuer with the option to deliver additional debt instruments in lieu of regularly scheduled interest payments. The additional debt instruments are aggregated with the original debt instruments and are not considered as a payment made on the original debt instrument. This suggests different treatment based on what the holder receives: cash or additional debt. Treasury Regulation 1.1272-1(c)(5) states that the issuer is deemed to exercise or not exercise an option or combination of options in a manner that minimizes the yield on the debt instrument. In other words, if paying interest in kind produces a lower yield than making cash interest payments, the debt instrument is assumed to include additional debt instruments throughout its life. However, this is a simplified approach, because it assumes only two possible outcomes – all payments are made in cash or all payments are made in additional securities. Real life examples of PIK debt instruments show greater complexity. For example, CUSIP 25212WAA8 is a 12% 7 year note issued by Dex One Corporation. However, if the company decides to pay in kind, the rate goes up to 14%. Additionally, the company may decide to change the method of payment from one period to another – either pay the entire amount in cash or 50% in cash and 50% in kind. This debt instrument pays twice a year for 7 years and each one of the 14 payments can be handled differently. The broker dealer and the client would be required to evaluate each scenario to determine the scenario with the lowest yield. Given the number of possible outcomes as well as complexity of the calculation, these rules are too cumbersome and impractical. We would suggest simplifying them and assuming that PIK bonds will always pay in additional debt instruments.	SIFMA requests that IRS provide penalty relief for reporting of these debt instruments until additional guidance can be issued simplifying the rules to allow brokers to assume that PIK bonds will always pay in additional debt instruments.
Debt instrument evidenced by a physical certificate	The marketplace lacks sufficient information regarding debt instruments that are evidenced by a physical certificate, which is not held by a securities depository or by a clearing organization. Brokers will have no way knowing the relevant information to accurately report. Some	SIFMA respectfully requests the IRS exclude these instruments from cost basis reporting requirements.

[17] Notice 2010-28; https://www.irs.gov/pub/irs-drop/n-10-28.pdf

unless such certificate is held by a securities depository or by a clearing organization	examples may include promissory notes and ventures backed by real estate. Below are three specific examples to illustrate the difficulty brokers face: • Rainier Preston Hollow Investors LP Senior Note 8.000% 05/01/17 REG DTD 05/25/06 • Rainier Sunwest Portfolio Investors LP 9.25% Senior Participating NTS 9.250% 04/01/18 REG • GWG HLDGS INC Renewable Secured Debenture 6.500% 06/30/16 REG DTD 07/01/14	
Preferred instruments that trade with the accrued interest paid into the price (dirty price)	Certain preferred instruments are traded with the accrued interest paid into the price, commonly referred to as a "dirty price." In these instances, proper calculation imposes an undue burden on brokers and, moreover, these securities are sometimes misidentified in securities masters as equity.	SIFMA respectfully requests the IRS exclude these instruments from cost basis reporting requirements.