

June 28, 2007

Mr. Russ Sullivan
Democratic Staff Director
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Mr. Kolan L. Davis
Republican Staff Director
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Dear Messrs. Sullivan and Davis:

The Securities Industry and Financial Markets Association (SIFMA)¹ appreciates the opportunity to comment on the Senate Finance Committee's bipartisan staff discussion draft on basis reporting. The draft proposal would expand gross proceeds reporting requirements for brokers and require brokers to report the adjusted basis of securities sales to taxpayers and the Internal Revenue Service (IRS). SIFMA supports efforts to improve tax compliance and welcomes the opportunity to work with the Committee to develop effective basis reporting rules that will reduce the misreporting of capital gains and losses.

In November 2006, SIFMA provided written comments on an adjusted basis reporting proposal offered by the Joint Committee on Taxation (JCT). We have also held several meetings with Finance Committee, House Ways and Means, JCT, Government Accountability Office (GAO), Treasury Department and IRS staff to discuss policy and implementation issues. This comment letter provides specific recommendations that we believe are necessary to implement effective basis reporting systems that improve on today's "best efforts" practices.

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

SIFMA would like to highlight five recommendations. A complete list of comments and recommendations is attached.

1. **Corporate Reporting.** SIFMA strongly opposes the proposal to extend gross proceeds reporting (and thus adjusted basis reporting) to corporate customers and recommends this proposal be dropped. The Secretary of the Treasury already has the authority to extend gross proceeds reporting to corporations and can exercise this authority *without legislative action* if corporations are a significant source of noncompliance. Corporations are currently exempt from gross proceeds reporting because the information reported by brokers and their corporate customers will often differ due to timing and accounting differences. These differences would lead to numerous mismatches, making it difficult for the IRS to identify actual noncompliance. Moreover, the provision has not been included in previous tax gap proposals, has not been vetted and is overly broad. Brokers and the IRS should be allowed to focus their time and resources on implementing the new adjusted basis reporting requirements under the proposal, rather than diverting these resources to new reporting requirements that yield little or no tax compliance benefits.
2. **Regulatory Authority.** The Secretary of the Treasury should be granted broad regulatory authority to implement the new reporting requirements. Making brokers liable for reporting adjusted basis raises several questions and challenges that are outlined in the attached comments. Many of these issues are not addressed in the discussion draft, and Treasury is not granted authority to address them through regulation. SIFMA is concerned that existing regulatory authority under section 6045(a) is insufficient because the proposed legislative language does not provide enough flexibility and because of the manner in which the discussion draft proposes to amend section 6045. As a result, Treasury should be given broad regulatory authority to implement the new requirements and to provide safe harbors, uniform adjusted basis calculation rules, simplifying assumptions, and limited exceptions if justified.
3. **Effective Date.** The new reporting requirements should be effective for securities acquired 18 months after Treasury regulations are finalized (rather than 18 months after date of enactment). Brokers cannot develop or modify their basis reporting systems if they do not know the rules they must follow. Treasury will need enough time to issue a large body of regulations, and brokers will need enough time to develop and test their systems once those regulations are issued. Year-end information processing will also need to be addressed. If the new requirements take effect prematurely, many brokers will not be able to comply with the new law, and the basis information they provide to taxpayers and the IRS will not be uniform or reliable. The recommended effective date would allow the reporting requirements to be implemented in phases. A phased implementation would allow brokers and the IRS to focus their time and resources on the most common sources of misreporting, while ensuring that effective basis reporting systems are developed for all applicable securities within a reasonable period of time.
4. **Definition of Applicable Security.** The definition of “applicable security” should be clarified. The legislative language appears to require adjusted basis reporting for applicable securities that are subject to gross proceeds reporting. However, applicable securities are defined by reference to section 475(c)(2) of the Internal

Revenue Code (IRC). This reference creates confusion because the definition of a security under section 475(c)(2) is inconsistent with the one provided under the gross proceeds reporting requirements.

5. **Reporting Deadline.** S. 636, the *Reduce Wasteful Tax Forms Act of 2007*, introduced by Sen. Schumer, should be incorporated into the proposal. The new reporting requirements will greatly increase year-end processing for brokers and custodians, thus increasing the number of corrected 1099 and cost basis statements that will have to be issued to taxpayers and the IRS. The issuance of corrected statements can be confusing and costly for taxpayers, particularly if they have already filed their tax returns. S. 636 would delay the filing deadline for 1099 statements by two weeks, from January 31 to February 15. This extension would reduce the number of corrections needed, mitigate challenges raised by post-year-end reclassifications and facilitate other requirements under the proposal as explained in our comments.

Thank you for the opportunity to comment on the bipartisan discussion draft. We look forward to continuing to work with you on this important issue.

Sincerely,



Shahira Knight
Managing Director



Patricia McClanahan
Managing Director

Attachment

cc: Thomas A. Barthold, Acting Chief of Staff, Joint Committee on Taxation
John L. Buckley, Majority Chief Tax Counsel, House Committee on Ways and Means
Jon Traub, Minority Chief Tax Counsel, House Committee on Ways and Means

SIFMA COMMENTS ON MAY 25TH
STAFF DISCUSSION DRAFT

Proposal #1 Require financial institutions to report gross proceeds with respect to securities sold by corporate customers.

Comments

- Corporations are currently exempt from gross proceeds reporting because information reported by brokers and corporate taxpayers would differ for at least two reasons. First, gross proceeds are reported on a calendar year basis, but many corporations file taxes on a fiscal year basis. Second, gross proceeds are generally reported on a trade date basis, but many corporate taxpayers use other tax accounting methods, such as the mark-to-market method. Because of these accounting and timing differences, gross proceeds reporting for corporations would lead to numerous mismatches, thus providing little value to the IRS.
- Treasury already has the authority to require gross proceeds reporting with respect to corporations. If corporations are a significant source of noncompliance, the Secretary can require information reporting for corporations without legislative action.
- The provision has not been included in previous tax gap proposals, has not been vetted and is overly broad. For example, the provision would require gross proceeds reporting for foreign corporations, tax-exempt organizations and government-owned corporations. The provision would also require reporting with respect to regulated investment companies (RICs), brokers, banks, and securities firms. These entities are typically nominees who are already obligated to report gross proceeds to the actual taxpayers. Applying the new requirement to these exempt recipients would merely result in duplicative reporting with no tax compliance benefits.

Recommendations

SIFMA strongly opposes this proposal and recommends that corporations be dropped from the gross proceeds and adjusted basis reporting requirements of the discussion draft. Gross proceeds reporting for corporate customers would be a significant undertaking that produces little (or no) benefits for the IRS. The IRS already has the authority to require gross proceeds reporting for corporations and could exercise this authority without legislative action if a tax compliance problem exists. Brokers and the IRS will need to focus their time and resources on implementing the new adjusted basis reporting requirements under the proposal, rather than diverting these resources to new reporting requirements that yield little or no tax compliance benefits.

Proposal #2 Require reporting of gross proceeds with respect to publicly-traded options for which market quotations are readily available on an established market.

Comments

- Treasury already has the authority to require gross proceeds reporting for options, but has chosen to exempt them for reasons that are still valid today. In 1995, GAO examined the exemption in response to a Congressional inquiry. IRS officials explained that timing differences make gross proceeds reporting on options less useful compared to other broker transactions. For example, options premiums received in one year may not be taxable until a future year or they may be used only to adjust the basis of the underlying property. As a result, IRS officials questioned how well the reported information could be used to identify actual noncompliance rather than generate false leads. Pursuing false leads would waste IRS resources and burden compliant taxpayers.
- In their 1995 Annual Tax Report, GAO reported:

“IRS officials said the exclusion arose from both the complexity of options transactions and from the high administrative burden associated with reporting and using such information....Before requiring information reporting for options, IRS officials believe IRS needs to determine (1) whether a compliance problem exists and (2) how the obstacles discussed above can be resolved.”

Recommendations

SIFMA is not aware of any study conducted since GAO examined the exemption in 1995, nor are we aware of any tax gap reports that have identified options as a compliance problem. Moreover, the obstacles identified by the IRS in 1995 are still valid today. As a result, SIFMA recommends that IRS conduct a study on these issues, as recommended in 1995, before requiring information reporting for options. The Secretary has the authority to extend gross proceeds reporting to transactions in options without legislative action if a study concludes that such reporting is justified.

Proposal #3 It is our understanding that the intent of the proposal is to require brokers to report adjusted basis and holding period information for “applicable securities” that are subject to gross proceeds reporting. An “applicable security” means: (1) A security defined under IRC section 475(c)(2) provided that market quotations are readily available on an established market on the date of acquisition, (2) interests in a mutual fund, (3) interests in a Real Estate Investment Trust (REIT) that must register with the Securities and Exchange Commission, and (4) any other financial instrument designated by Treasury through regulations.

Comments

The scope of the definition of “applicable securities” is unclear. In addition, adjusted basis reporting for some securities raises questions that need to be addressed before brokers can comply with the reporting requirements.

- *Foreign securities.* Foreign issuers generally do not report the U.S. tax consequences of their corporate actions. As a result, brokers may not know how these actions affect basis.
- *Publicly Traded Partnerships (PTPs).* Under current law, some partnerships are taxed like flow-through entities even though the partnership interest is publicly-traded. These partnerships already report basis information to their partners and the IRS on Schedule K-1. Brokers do not receive the information and cannot readily obtain it.
- *Regulated Futures Contracts.* Brokers are already required to report realized and unrealized profits and losses for regulated futures contracts. Including these instruments in the proposal would result in duplicative reporting requirements, which could confuse taxpayers who may end up adjusting their basis twice.
- *Widely-Held Fixed Investment Trusts (WHFITs).* Treasury Regulation section 1.671-5 already requires both 1099 and cost basis reporting with respect to WHFITs. These regulations, which took effect on January 1, 2007, provide basis reporting rules that are more consistent with the nature of WHFITs than the staff proposal.
- *Mutual Fund Shares.* Under current law, funds and brokers generally report average cost basis to their shareholders using one of two methods prescribed by regulations. Even if mutual fund shares are acquired in the future, historical basis information must be known in order to calculate average cost.

Recommendations

- The scope of the new reporting requirements needs to be clarified.
 1. The proposal appears to require adjusted basis reporting for “applicable securities” that are subject to gross proceeds reporting. This requirement should be clarified by plainly stating in the legislative history that adjusted basis reporting is not required if gross proceeds reporting is not required.
 2. An “applicable security” is defined by reference to IRC section 475(c)(2). This reference creates confusion because the definition of a security under section 475(c)(2) differs from the regulatory definitions of “security” and “sale,” which in combination, determine

the scope of gross proceeds reporting under section 6045. The inconsistent definitions create interpretative issues regarding the scope of the reporting requirements. The adjusted basis reporting requirements should apply to reportable sales under section 6045 for which market quotations are readily available on an established securities market on the acquisition date.

- Provide a statutory exemption from the reporting requirements for:
 1. Interests in publicly-traded partnerships. These partnerships send basis information directly to their partners and to the IRS on Schedule K-1. Brokers do not have access to this taxpayer-specific information. Even if brokers could access this information, the reporting would be duplicative since the taxpayer and the IRS already receive the information from the partnership.
 2. Regulated futures contracts. Brokers are already required to report realized and unrealized profits and losses with respect to these instruments. Adjusted basis reporting would result in duplicative reporting requirements.
- Defer to Treasury Regulation section 1.671-5 with respect to WHFITs. The regulation provides more specific basis reporting rules for these vehicles.
- Direct Treasury to prescribe regulations explaining how basis is to be adjusted when foreign issuers do not report the U.S. tax consequences of their corporate actions.
- As noted above, SIFMA recommends that gross proceeds reporting should not be extended to options until IRS studies the relevant issues as recommended in 1995. If a study finds that information reporting is justified, Treasury could use its existing regulatory authority to overturn the current exemption, thus subjecting options to gross proceeds reporting and adjusted basis reporting (based on the general rule under the proposal). If the staff decides to create a special rule that requires adjusted basis reporting for options, the proposal should grant Treasury broad regulatory authority to address several issues, including which options transactions are reportable, how basis should be captured (i.e., transactional reporting or realized and unrealized gains/loss reporting for section 1256 contracts), guidelines for reporting and reconciling transactions at the end of the year, and broker reporting obligations under various scenarios (e.g., options that lapse without being exercised, options that are assigned, the writing of options, rights imbedded in stock).

Proposal #4

The adjusted basis reporting requirement applies to securities that are purchased by the customer or acquired through gift, bequest or transfer.

Comments

- Gift taxes paid on gifted securities will increase the taxpayer's basis in the security. However, brokers have no way of knowing how much gift tax was paid to make appropriate basis adjustments. Moreover, calculating adjusted basis for gifted securities requires tracking two basis numbers (the donor's cost and the fair market value of the security at the time of transfer or date of sale). Modifying basis systems to track two numbers would be prohibitively expensive. It is difficult to justify this expense – especially since the broker's calculations will often be less accurate than the taxpayer's, resulting in numerous mismatches.

Recommendations

- The statute should clarify that brokers are not required to adjust basis to reflect gift taxes paid since this information is not known to the broker.
- The statute should provide a special rule that allows brokers to report carryover basis for gifted securities, thus eliminating the need to track two basis numbers. The broker would be required to "flag" the number for the IRS if the gifted security had declined in value (which is uncommon since most donors do not gift depreciated securities). This rule would allow for an accurate basis calculation if the security appreciated in value and would signal to the IRS that a loss reported by the taxpayer could be overstated if the security depreciated.
- Treasury should be granted regulatory authority to implement the basis reporting requirements with respect to gifted and inherited securities.

Proposal #5

Require "persons" that transfer securities to a broker to provide that broker with a written statement containing the information needed to determine adjusted basis. The statement must be furnished by the earlier of 45 days after the date of transfer or January 15 of the year following the transfer.

Comments

- Given the large volume of transferred securities, a non-centralized paper transfer system would be inefficient, burdensome, unmanageable, and prone to error. Moreover, it would create disputes between firms if information is not received in a timely manner or not received at all.
- The January 15 deadline for end-of-year transfers will be difficult for many brokers to manage. Many brokers are already printing their 1099 statements on January 15 in order to meet the statutory January 31 deadline for 1099 statements.

Recommendations

- The statute should require brokers (defined under section 6045) to transfer basis information electronically within 10 business days of the transfer. Exceptions could be provided through regulations. Non-brokers, such as individuals and estates, would not be required to participate in the electronic system (they could transfer basis information in writing and be granted a longer deadline).
- The statute should require information to be transferred through one or more clearinghouses. Securities firms currently use the Depository Trust Clearing Corporation (DTCC). The DTCC has an existing electronic transfer system (called ACATs), and the Cost Basis Reporting Service ("CBRS") is part of that system. Financial institutions that do not currently participate in this system could build and use a different industry system.
- To facilitate adjusted basis reporting for inherited and gifted securities, the legislative history should clarify that the definition of "persons" includes estates, trusts and donors. In addition, the legislative history should clarify that taxpayers who transfer information to brokers are required to retain appropriate documentation. For example, brokers should not be responsible for verifying, collecting and retaining death certificates (in the case of inherited securities) or client tax returns (in the case of gifted securities).
- SIFMA recommends adopting the provisions of S. 636, which would delay by two weeks the filing deadline for 1099 statements. This would alleviate time pressures created by end-of-year transfers.

Proposal #6

Require issuers to provide returns describing any corporate actions affecting basis and the quantitative effect of those actions on basis. The return must be filed the earlier of 45 days after the action or January 15 of the year following the action. A statement with the same information must also be provided to each holder of the security (or a nominee) by January 31 of the year following the corporate action. Nominees must provide this information to the owner of the security. The Secretary may waive the requirement to furnish returns and statements if the issuer makes this information publicly available in a manner prescribed by regulations.

Comments

- There are approximately one million corporate actions annually. Requiring issuers to file returns and customer statements would be inefficient and burdensome.
- As a policy matter, information on corporate actions should be made publicly available to shareholders regardless of basis reporting

requirements. A corporation should be responsible for informing its shareholders of corporate actions and their tax consequences.

- As indicated previously, the January 15 deadline for transmitting information on end-of-year actions may not be manageable for many brokers who are already printing 1099 statements in order to meet the January 31 reporting deadline.

Recommendations

- The statute should require that generic information on corporate actions (including the final terms and prorations of consideration) and the U.S. tax consequences of those actions be made publicly available by the issuer within 10 business days of the action. This information should be made available through one or more clearinghouses. In addition, initial corporate action announcements should include a general description of the action's tax consequences and its impact on domestic individuals.
- This statutory requirement should be clarified to include foreign issuers with shares represented in American Depositary Receipts (ADRs) and U.S. listed ordinary shares. These foreign issuers should be required to provide valuation and date information with respect to their corporate actions (date information is needed to enable brokers to determine the U.S. dollar value of any payments valued in a foreign currency).
- In 2003, the IRS issued proposed regulations that required issuers to make information about corporate actions publicly available. The regulations were finalized with respect to corporate inversions only. Other parts of the proposed regulations were allowed to expire – not because of technical or substantive problems – but presumably because Treasury wanted the opportunity to reconsider the regulations after additional authority on issuer reporting was granted in 2004. These regulations reflect at least three years of discussions that produced a workable product with input from all affected parties. The statute should direct the IRS to proceed with regulations on issuer reporting.

Proposal #7

The proposal is silent with regard to several policy issues that must be addressed before basis reporting can be implemented.

Comments and Recommendations

Making brokers liable for reporting adjusted basis raises several questions and challenges that are not addressed in the discussion draft. Moreover, the discussion draft does not grant Treasury the authority to address these issues through regulation. SIFMA is concerned that existing regulatory authority under section 6045(a) is insufficient because the proposed legislative language does not provide enough flexibility to address the policy nature of some of these issues and because of the manner in which the discussion draft

proposes to amend section 6045. Finally, Treasury may fail to prescribe regulations with respect to certain issues unless the Secretary is directed to do so by law.

- *Post-Year-End Reclassifications.* The statute does not provide any flexibility with regard to post-year-end reclassifications of distributions from mutual funds, REITs and other issuers. The statute should direct Treasury to provide a safe harbor or simplifying rule for capturing the effect of these reclassifications on tax basis. A safe harbor should allow for de minimis exceptions and a cut-off date.

Without a de minimis exception, taxpayers will receive corrected 1099 statements for very small basis adjustments. This could confuse many taxpayers and create considerable expenses for those who have to amend their tax returns. If the corrected amounts are very small, taxpayers may not go through the time and expense of amending old tax returns, resulting in increased mismatches for the IRS. Overall, the costs imposed on taxpayers, brokers and the IRS would certainly outweigh any revenue gains for very small basis adjustments.

Similarly, a cut-off date is desirable because, at some point in time, taxpayers must be able to rely on their 1099 statements without the fear of future corrections that require costly amendments to tax returns. If reclassifications are received after a certain date, brokers should not be required to adjust closed investor positions, and taxpayers should not be required to file amended tax returns.

Finally, delaying the filing deadline for 1099 statement by two weeks (as provided under S. 636) would substantially reduce the number of corrected 1099s, thus mitigating the problems posed by post-year-end reclassifications.

- *Debt Instruments.* Adjusted basis reporting with respect to debt instruments poses many questions and challenges. For example: (1) the income inclusion rules and basis reporting rules differ with each other. These rules must be reconciled to work in tandem or the disparity will create significant complexity and confusion for taxpayers. (2) It is unclear how basis should be adjusted to reflect market discounts and bond premiums if the debt instrument is acquired in secondary markets. (3) It is unclear how modifications, exchanges and restructuring of debt instruments affect basis because the tax law is unclear and legal opinions differ. (4) It is unclear how basis adjustments should be made for real estate mortgage investment conduits (REMICs) and other collateralized debt obligations (CDOs). Interest-only and principal-only REMICs and CDOs present unique challenges because the relevant tax factors for original issue discount and market discount income are determined from the expected yield at issuance. Due to the frequency and uncertainty of the timing of prepayments on mortgage loans, it is virtually impossible to re-calculate the

expected yield based on each individual taxpayer's actual acquisition price. (5) It is unclear how to calculate adjusted basis and gross proceeds for hybrid securities because the accrued interest is not stated separately; it is included in the price of the security. (6) Some debt instruments include both debt and equity components. The combined instrument has a readily available market value (and is therefore subject to the proposal's reporting requirements). However, the *components* of the instrument do not have ascertainable market values because they are not traded separately. As a result, brokers have no way of knowing the basis of the individual components when the components are sold or otherwise separated (i.e., they have no way of knowing how to allocate basis for the unit between the components).

Accordingly, Treasury should be granted broad regulatory authority to prescribe regulations with respect to debt instruments. The legislative history should direct Treasury to provide (1) standard rules with respect to *each* type of debt instrument so that all brokers are using uniform rules to adjust basis, (2) simplifying assumptions to calculate the adjusted basis of complex instruments, (3) clarifications of current law, (4) guidelines for reconciling the income inclusion and basis reporting rules, and (5) exceptions for certain instruments if justified. It is important to recognize that brokers cannot comply with the reporting requirements for debt instruments until standard rules and guidelines are provided.

- *Wash Sale Transactions.* The statute does not provide any flexibility with regard to wash sale transactions. Capturing the effect of wash sales on basis is extremely complex. Brokers may not know that a wash sale has occurred (even if it occurs within the same account) because "substantially identical" securities may have different CUSIP numbers (e.g., rights and warrants on a stock). Moreover, wash sales that occur at the end or beginning of a calendar year are likely to necessitate corrected 1099 statements because of the look-forward and look-back rules. Finally, it is unlikely that taxpayers would buy and sell substantially identical securities in the same account if they are trying to game the system by generating artificial tax losses. As a result, requiring brokers to modify their systems to account for wash sales would create considerable costs and complexity without improving tax compliance. Similar costs would arise if brokers were modifying their systems to account for the sales load basis deferral rules under section 852(f), losses on sales of fund shares held six months or less under section 852(b)(4), the conversion gain rules under section 1258, and the constructive sale rules under section 1259.

Given these considerations, the statute should provide that brokers are not required to adjust basis or holding period to reflect wash sale transactions, straddles, hedges, and similar transactions that require knowledge of the taxpayer's other positions in a security. If the staff decides that brokers should be required to capture the effect of these transactions, we agree that the proposal must be limited to transactions within the same account.

However, Treasury must be granted the authority to provide for simplifying assumptions and workable rules. For example, substantially identical securities would have to be defined as securities with identical CUSIP numbers; brokers should be allowed to ignore dividend reinvestments, and simplifying rules for year-end transactions would need to be developed.

- *Short Sales.* Under the existing regulations, brokers may report gross proceeds from short sales either on the date the short sale is entered into or the date the short sale is closed. Most brokers report on the earlier date because it is the most readily identifiable event. Brokers need to know how to handle short sales, particularly since the basis information is not available at the time of the short sale.
- *Taxpayer Records.* Basis is often affected by taxpayer actions that are not known to the broker. As a result, the taxpayer's basis information may be more accurate than the broker's basis information. The statute should allow taxpayers to report their own adjusted basis information if they have documentation to support their calculations. If taxpayers report their own basis information on their tax returns, they should be required to reconcile the difference between their information and the broker's information on the return. Brokers would not be required to input the taxpayer information into their systems since they would not know about it. If basis information is supplied to the broker by the taxpayer, the broker should be required to "flag" the information when it is reported to the IRS to indicate the source of the information.
- *Reliance on Third-Party Information.* Basis calculations are affected by information and actions that are not observed by the broker. A proposal issued by the Joint Committee on Taxation in 2006 provided that brokers could rely on information provided by third parties as long as this reliance is disclosed to taxpayers and the IRS. This provision should be adopted in the staff proposal. The legislative history should explain the scope of the provision. Specifically, brokers should be able to rely on basis information provided by transfer agents, custodians, other brokers, donors, heirs, estates, trusts, and taxpayers. If the broker is reporting an adjusted basis number provided by one of these entities, the broker must disclose this reliance to the taxpayer and the IRS. However, if the broker uses information provided by its agent or service provider to calculate basis or prepare Forms 1099 that include adjusted basis information, the reliance would not be disclosed.
- *Transition relief from reporting penalties.* As explained throughout these comments, reporting adjusted basis can be very complicated and imprecise. Treasury will need time to issue and refine regulations, and brokers will need time to develop, modify and test their basis reporting systems. As a result, the statute should provide transition relief from reporting penalties for two years after the reporting requirements take effect with respect to each security class.

Proposal #8

All of the reporting requirements are effective for securities acquired 18 months after the date of enactment.

Comments

- As outlined throughout these comments, there are numerous technical, operational and policy issues that must be resolved before the new reporting requirements take effect. If these rules are not provided in the statute, they must be provided through regulations. Brokers cannot develop or modify their systems if they do not know the rules that will apply to various transactions and basis calculations. Treasury will need enough time to issue regulations, and brokers will need enough time to develop and test their systems. Moreover, issues arising in the year-end processing of information will also need to be addressed. The proposed effective date does not provide a realistic timeline. If the new reporting requirements take effect prematurely, the basis information provided to taxpayers and the IRS will not be uniform or reliable. In fact, inadvertent miscalculations of basis in existing accounts today because of incomplete regulations could taint the basis data for those accounts into the future.

Recommendations

- The reporting requirements should be effective at least 18 months after final Treasury regulations are issued. This will give brokers time to develop, modify and test their basis reporting systems after they know the rules with which they must comply. The rules should also take effect on January 1 (not in the middle of the calendar year).
- Treasury will have to develop a substantial body of regulations to implement basis reporting for all of the instruments covered by the proposal. Most brokers will need to make significant changes to their systems, and smaller brokers will have to build new systems from scratch. As a result, the new requirements will be most effective if they are implemented in phases. For example:
 - o *Phase 1 – Domestic Equities and Mutual Funds.* Treasury could be directed to finalize regulations with respect to domestic equities and mutual fund shares within 12 months of the date of enactment. The requirements would be effective with respect to domestic equities and mutual fund shares acquired 18 months after these regulations are finalized.
 - o *Phase 2 – Debt Instruments.* Treasury could be directed to finalize regulations with respect to debt instruments within two years of the date of enactment (thus giving them 12 months to write regulations after phase 1 regulations are finalized). The requirements would be

effective with respect to debt instruments acquired 18 months after these regulations are finalized.

The process of writing regulations and implementing the requirements would continue until all securities subject to basis reporting requirements are covered. A phased approach would allow brokers and the IRS to initially focus their time and resources on building effective basis reporting systems for the most common sources of misreporting, while ensuring that all applicable securities are eventually covered by the reporting requirements.