

MEMO# 23387

April 9, 2009

ICI Comment Letter to Treasury and IRS on Mandatory Cost Basis Reporting

[23387]

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 17-09
BROKER/DEALER ADVISORY COMMITTEE No. 21-09
OPERATIONS MEMBERS No. 9-09
SMALL FUNDS MEMBERS No. 26-09
TAX MEMBERS No. 8-09
TRANSFER AGENT ADVISORY COMMITTEE No. 31-09 RE: ICI COMMENT LETTER TO
TREASURY AND IRS ON MANDATORY COST BASIS REPORTING

The Institute today submitted to the Internal Revenue Service and Treasury Department the attached letter requesting guidance on specific issues raised by the new mandatory cost basis reporting requirement enacted last October as part of the economic stabilization legislation.[\[1\]](#)

New Statutory Requirement

The new legislation, which applies to fund shares acquired beginning in 2012, requires brokers (including mutual funds) to report to customers and the IRS: (1) the customers' cost basis in securities (including mutual fund shares) sold or redeemed; and (2) the long-term or short-term nature of any gain or loss.

In the case of funds, the shareholder's cost basis of shares subject to reporting is determined "in accordance with the broker's default method unless the customer notifies the broker that he elects another acceptable method under [Internal Revenue Code] section 1012 with respect to the account in which such stock is held." Cost basis may be calculated under average cost or any method (such as first-in/first-out or highest-in/first-out) that involves identification of specific shares.

The new law also provides rules requiring brokers who transfer securities to another broker to furnish to the transferee a written statement setting forth such information as prescribed in regulations for purposes of enabling the transferee to meet the basis reporting requirements. The statement must be furnished no later than the earlier of 15 days after the date of the transfer or January 15 of the year following the calendar year in which the

transfer took place. The legislation also imposes a penalty on a transferring broker who fails to furnish the written statement.

IRS Request for Comments

Recently, the IRS issued Notice 2009-17, which requested comments on 36 specific questions.^[2] Among other things, the Notice asked for comments on the parties subject to the new reporting requirements, the basis method elections, reconciling cost basis information provided to IRS by brokers with the information reported by customers on their tax returns, mechanical computation issues, reporting on transfers, reporting by issuers, and broker practices and procedures.

Institute Letter

The Institute's letter emphasizes, at the outset, that effective implementation of the cost basis reporting legislation by the financial services industry will require a herculean effort within a very short time period. Many critically important systems changes cannot be made without a thorough understanding of exactly what firms will be required to do. Binding IRS regulations, in many cases, may be necessary to provide the comfort that firms will need before spending millions of dollars on new systems. Consequently, the need for prompt IRS guidance is acute.

The letter focuses first on implementation issues. These issues include: (1) any requirements imposed on brokers for communicating to their customers the broker's default methodology and the ability of shareholders to select other methods of computing cost basis; (2) whether shareholders will be required to use the basis information provided by the brokers; (3) requirements for identifying adequately the shares redeemed or sold, including formulaic broker default and customer identification methods (such as redeeming first those shares that have the highest cost basis and, accordingly, the lowest taxable gain); (4) the time for selecting the basis methodology to be applied to a redemption or sale; (5) error correction procedures; (6) flagging inaccurate data; (7) the treatment of wash sales; (8) the January 2012 effective date's applicability to shares of mutual funds, closed-end funds and exchange-traded funds; and (9) treating shares in each separate class of a fund as held in different accounts.

The letter then discusses basis calculations. Issues involving adjustments to cost basis include: returns of capital, the sales load basis deferral rule of Code section 852(f), and wash sales. Issues relating specifically to calculating basis under the average cost method include: (1) the use of average cost when a shareholder has multiple accounts in a fund; (2) the treatment of old and new shares in a fund; (3) the election to combine old and new shares; (4) eliminating the double-category method of computing average cost; and (5) electing out of the average cost basis method. In addition, the letter discusses two other basis calculation issues: default rules for re-registered shares; and the treatment of customer-provided information.

Issues involving the transfer of fund shares include: (1) defining "brokers" and required information; (2) transfer methods; (3) partial transfers; (4) reporting timeframes; (5) the duties and responsibilities involved in transmitting data; (6) post-transfer changes to cost basis; and (7) transfers of voluntary basis information.

The letter also addresses several cost basis reporting issues including: (1) the parties responsible for cost basis reporting; (2) information to be provided on IRS forms; (3) requirements for amending these forms; (4) clarification that the February 15 reporting deadline applies to all information provided to a client in one envelope; and (5) reporting to

S corporations.

Finally, the letter addresses record retention issues and urges broad penalty relief. This relief would be provided for: (1) combining pre- and post-effective date shares; (2) data provided by shareholders or third parties; (3) reporting to S corporations; and (4) the transition period.

Karen Lau Gibian
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[Attachment](#)

endnotes

[1] See Institute Memorandum (22916) to Bank, Trust and Recordkeeping Advisory Committee No. 31-08, Broker/Dealer Advisory Committee No. 37-08, Operations Members No. 17-08, Tax Members No. 40-08, and Transfer Agent Advisory Committee No. 59-08 (among others), dated October 3, 2008.

[2] See Institute Memorandum (23244) to Tax Committee No. 4-09, dated February 10, 2009; Memorandum (23261) to Transfer Agent Advisory Committee No. 15-09, dated February 18, 2009.

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