MEMO# 21952

November 14, 2007

House Passes Tax Bill that Includes Mandatory Cost Basis Reporting, Extension of Flow-Through and other Provisions

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 50-07
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INTERNATIONAL MEMBERS No. 33-07
OPERATIONS MEMBERS No. 25-07
PENSION MEMBERS No. 67-07
SMALL FUNDS MEMBERS No. 107-07
TAX MEMBERS No. 50-07
TRANSFER AGENT ADVISORY COMMITTEE No. 80-07 RE: HOUSE PASSES TAX BILL THAT INCLUDES MANDATORY COST BASIS REPORTING, EXTENSION OF FLOW-THROUGH AND OTHER PROVISIONS

The House of Representatives passed a tax bill [1] on November 9, 2007, that, among other things, would (1) require brokers, including mutual funds, to provide cost basis information to customers and the Internal Revenue Service upon the sale or redemption of securities, and (2) extend several provisions that are set to expire at the end of 2007. [2]

Cost Basis Reporting

Section 622 of the bill would amend section 6045 of the Internal Revenue Code to require brokers, including mutual funds, to report to customers and the IRS the customers' cost basis in securities (including mutual fund shares) sold or redeemed. Brokers also would be required to report whether any gain or loss with respect to those securities is long-term or short-term (within the meaning of section 1222). In general, cost basis reporting would apply to fund shares acquired after December 31, 2008.

For any stock (other than stock in any open-end fund), the customer's adjusted basis would be determined using the first-in, first-out method, unless the customer notifies the broker that he wishes to use specific identification and makes an adequate identification of the stock sold or transferred. For these purposes, an "open-end fund" is a regulated investment company, as defined in section 851 (a "RIC"), which is offering for sale or has outstanding any redeemable security of which it is the issuer and the shares of which are not traded on an established exchange.

For interests in an open-end fund acquired after December 31, 2008, and before January 1, 2011, the customer's adjusted basis would be determined in accordance with any method currently acceptable under section 1012 (average cost, first-in, first-out, or specific identification) with respect to the account in which such interests are held. It appears that, for shares acquired during this time period, investors would not be required to use the basis information provided by the fund and could report their adjusted basis under any acceptable method.

For interests in an open-end fund acquired after December 31, 2010, the customer's adjusted basis would be determined in accordance with the fund's default method, unless the customer notifies the broker that he elects another acceptable method under section 1012 with respect to the account in which such interests are held.

This proposal would cover any specified security acquired on or after the effective date if such security (i) was acquired through a transaction in the account, or (ii) was transferred to such account from another account in which such security was covered by the basis reporting requirement, but only if the broker received a statement under new section 6045A (discussed below) with respect to the transfer.

The bill would amend section 1012 to provide that, in the case of the sale, exchange or other disposition of a specified security, the basis calculation methods provided under section 1012 would be applied on an account-by-account basis. For open-end funds, any stock acquired before January 1, 2009, would be treated as a separate account from any such stock acquired by the customer on or after that date. In other words, fund shares within an existing account that were acquired before the effective date would not be subject to basis reporting, but funds would be required to report basis information on shares in that account acquired after the effective date. Funds could make an election, however, to treat all stock in a fund held by a shareholder as securities covered by the cost basis reporting requirement, without regard to the date of the acquisition of the stock. Use of this election would mean that the fund would be required to report basis information for all shares in that account, regardless of acquisition date. This election would be made separately for each shareholder within a fund.

Except as otherwise provided in regulations, the customer's adjusted basis would be determined without regard to wash sales under section 1091, unless the transactions occur in the same account with respect to identical securities.

The bill generally would extend the reporting date for year-end tax statements to shareholders from January 31 to February 15.

The bill would add a new section 6045A that would require 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 would have to be furnished no later than the earlier of 45 days after the date of the transfer, or January 15 of the year following the calendar year during which the transfer took place. The bill also would add a penalty under section 6724(d), assessable upon the transferring broker, if the broker fails to furnish the written statement.

Flow-Through

Section 303 of the bill would extend for one year the exemption from withholding taxes for interest and short-term capital gains paid by RICs to foreign shareholders under section 871(k)(1) and (2). This provision would apply to dividends with respect to taxable years of RICs beginning after December 31, 2007.

Section 311 of the bill would extend for one year the provision under section 2105(d) that treats stock in certain RICs as not deemed property within the United States for purposes of determining the estate of a nonresident not a citizen. This provision would apply to decedents dying after December 31, 2007.

Distributions from IRAs for Charitable Purposes

Section 306 of the bill would extend until December 31, 2008, the exemption from tax under section 408(d)(8) for distributions from individual retirement plans for charitable purposes. The provision would apply to distributions made in taxable years beginning after December 31, 2007.

Distributions from Retirement Plans to Individuals Called to Active Duty

Section 310 of the bill would extend to December 31, 2008, the treatment of certain distributions from retirement plans to individuals called to active duty under section 72(g)(2)(G). The extension would apply to individuals ordered or called to active duty on or after December 31, 2007.

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endnotes

[1] The text of the bill, The Temporary Tax Relief Act of 2007 (H.R. 3996), can be found on the following website: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3996eh.txt.pdf.

[2] The text of the mandatory cost basis reporting (with respect to mutual funds) and extender provisions remains unchanged from that contained in the tax reform bill introduced by Ways and Means Committee Chairman Charles B. Rangel in October. See Institute Memorandum [21898] to Bank, Trust and Recordkeeper Advisory Committee No. 47-07, Broker/Dealer Advisory Committee No. 69-07, Federal Legislation Members No. 9-07, International Members No. 29-07, Operations Members No. 23-07, Pension Members No. 61-07, Small Funds Members No. 101-07, Tax Members No. 47-07, and Transfer Agent

Advisory Committee No. 78-07, dated October 26, 2007.
