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Proposed Regulations on Cost Basis Reporting

[24045]

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 57-09
BROKER/DEALER ADVISORY COMMITTEE No. 69-09
OPERATIONS MEMBERS No. 31-09
SMALL FUNDS MEMBERS No. 78-09
TAX MEMBERS No. 39-09
TRANSFER AGENT ADVISORY COMMITTEE No. 95-09 RE: PROPOSED REGULATIONS ON COST BASIS REPORTING

As we previously informed you, [1] the Internal Revenue Service ("IRS") recently issued proposed regulations addressing the cost basis reporting requirement enacted by the Energy Improvement and Extension Act of 2008. This law requires brokers (including mutual funds) to report to the customer and the IRS upon the sale of securities, in addition to gross proceeds, the customer's cost basis in the securities sold and whether any gain or loss is long or short-term. [2] The proposed regulations also address how taxpayers compute basis when using the average cost method, and they include rules clarifying the application of the extended information reporting deadline from January 31 to February 15. [3] Finally, the proposed regulations include rules regarding the new reporting requirements imposed upon persons that transfer custody of stock and upon issuers of stock regarding corporate actions that affect the basis of the issued stock. [4]

The IRS has requested comments on these proposed regulations by February 8, 2010. A public hearing has been scheduled for February 17, 2010; outlines of topics to be discussed at the hearing also are due by February 8, 2010.

Definition of “Broker”

The term “broker” is defined currently in Treas. Reg. § 1.6045-1(a)(1) as any person that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others. The proposed regulations amend this definition to provide that a non-U.S. payor or non-U.S. middleman would be a broker to the extent provided in a withholding agreement described in § 1.1441-1(e)(5)(iii) between a qualified intermediary and the IRS or similar agreement with the IRS. The IRS and Treasury Department expect that such agreements generally will provide that the broker that is party to such agreement will be subject to the broker reporting requirements under section 6045 to the same extent as U.S. payors and U.S. middlemen. The government requests comments regarding the usefulness of information received from non-U.S. payors and non-U.S. middlemen, the costs to such parties of complying with this requirement, and other potential effects.

Form and Manner of New Broker Reporting Requirements

The proposed regulations provide that brokers must report adjusted cost basis and whether any gain or loss is long-term or short-term on IRS Form 1099-B (Proceeds from Broker and Barter Exchange Transactions) or any successor form under section 6045(a) when reporting the sale of a covered security. [5] The IRS clarifies that the adjusted basis that must be reported is the total amount paid by a customer or credited against a customer’s account as a result of the acquisition of securities, adjusted for commissions and the effects of other transactions occurring within the account. Brokers also must adjust the basis for information received on a transfer statement in connection with the transfer of a covered security (including gifted and inherited securities, discussed below), as well as information received from issuers of stock regarding the effect of corporate actions.

The proposed regulations generally do not require a broker to adjust a customer’s cost basis for transactions, elections, or events occurring outside the account. For example, brokers only are required to adjust basis to take into account wash sales if both the purchase and sale transactions occur within the same account. The proposed regulations also provide, in an example, that RICs and other brokers are not required to make adjustments to basis as a result of the sales load basis deferral rule of section 852(f) in certain situations; the example states that, when a RIC shareholder sells shares in one fund and purchases shares in another fund pursuant to a reinvestment right for which the sales load is waived, the transactions occur in two separate accounts. Therefore, the broker is not required to apply the sales load basis deferral rule. [6]

The proposed regulations generally maintain the current requirement that brokers report a sale of securities within an account on one return, even if the sale involves multiple acquisitions. Because, however, brokers must report whether any gain is long-term or short-term and must report non-covered securities separately from covered securities, a single sale in an account could require up to three different returns (e.g., the sale included covered securities held more than a year, covered securities held for one year or less, and non-covered securities). Although the IRS received suggestions that brokers be permitted to flag or indicate on the Form 1099 potential discrepancies between the broker-reported

basis and the basis the customer must report on the customer's tax return, the IRS did not adopt these suggestions. The government requests comments regarding whether additional information should be required on the Form 1099. [7]

Scope of Covered Securities and Treatment of Non-Covered Securities

The proposed regulations clarify that the new basis reporting requirements do not apply to securities that are exempt from all reporting under section 6045 at the time of their acquisition, even if those securities later become subject to gross proceeds reporting under section 6045(a). For example, a broker is not required to report adjusted basis for a security purchased by a tax-exempt organization even if the organization later loses its tax-exempt status and becomes subject to gross proceeds reporting.

A security transferred into an account in a non-sale transaction is a covered security under the proposed regulations if it was a covered security before the transfer and the transferee broker receives a transfer statement required under section 6045A indicating that the security is a covered security. A transferred security is presumed to be a covered security unless the transfer statement expressly states that the security is a non-covered security.

If a receiving broker does not receive a transfer statement or receives an incomplete transfer statement, the broker must notify the transferring broker and request a complete statement (though the receiving broker only is required to make this request once). If the receiving broker still does not receive a complete transfer statement, the broker is permitted to treat the security as a non-covered security.

If a broker receives a transfer statement after reporting the sale of the security to the customer and the IRS, the proposed regulations require the broker to file a corrected Form 1099-B if the original reporting was incorrect or incomplete. Similarly, a broker must file a corrected Form 1099-B if it subsequently receives a return required under section 6045B concerning corporate organizational actions, and such information was not reflected in the original Form 1099-B. The broker must file the amended Form 1099-B within thirty days of receiving the complete transfer statement or issuer statement regarding corporate organizational actions. The proposed regulations do not provide an exception for de minimis adjustments or for statements furnished beyond a specific period after the close of the calendar year, as suggested by commentators, but the IRS and Treasury Department request further comments regarding corrected reporting.

Some commentators expressed concerns that the classification of some types of financial instruments may not be clear (e.g., whether an instrument should be treated as stock or debt), and therefore a broker may not know which effective date for cost basis reporting to apply. In response to these concerns, the proposed regulations provide that, solely for the purpose of determining the correct effective date, any security an issuer classifies as stock is treated as stock. If no issuer classification has been made, the security is not treated as

stock unless the broker knows, or has reason to know, that the security is reasonably classified as stock under general tax principles.

The proposed regulations allow brokers to report adjusted basis and whether any gain or loss on a sale is long-term or short-term on the Form 1099-B for non-covered securities, on a security by security basis. Therefore, a broker may choose to report this information for any given non-covered security. A broker that chooses to report this information with respect to a non-covered security will not be subject to penalties under section 6721 (failure to file information returns with the IRS) or 6722 (failure to furnish payee statements) for any failure to report such information correctly, provided that the broker indicates on Form 1099-B that the sale reported is a sale of a non-covered security. [8]

Determination of Basis Method and Broker Default Methods

The proposed regulations specify that a broker must report basis using any permitted lot identification or basis determination method chosen by the customer, provided the customer provides a valid instruction (discussed below). If the customer does not provide valid instructions, the broker must report basis for RIC shares using the broker's default basis method, or, for all other securities, the first-in, first-out ("FIFO") method.

The proposed regulations do not prescribe a broker default method for RIC shares; each broker may determine its own default method. The proposed regulations also do not require a specific method or time in which brokers must communicate their default basis determination method to their customers.

Elimination of Double-Category Method

The proposed regulations eliminate the double-category method and provide that average cost is computed by averaging the basis of all identical stock [9] in an account regardless of holding period (i.e., single-category average cost). The proposed regulations include a transition rule that requires taxpayers using the double-category method to average the basis of all identical stock in an account on the date of publication of final regulations. The government requests comments as to whether the double-category method should be retained.

Order of Disposition of Shares Sold or Transferred When Using Average Cost

The proposed regulations specify that, in the case of the sale or transfer of shares of stock for which average cost is used, shares sold or transferred are deemed to be the shares first acquired (i.e., shares are decremented on a FIFO basis).

Wash Sales

The proposed regulations provide that taxpayers using average cost must apply the wash sale rules of section 1091 in computing average cost, regardless of whether the stock or security sold or otherwise disposed of and the stock acquired are in the same account or in different accounts.

For purposes of reporting, however, section 6045(g)(2)(B)(ii) provides that brokers must apply the wash sale rules only to acquisitions and sales in the same account and for identical securities. If a broker is required to apply the wash sale rule for reporting purposes, the broker must report the amount of the disallowed loss in addition to adjusted basis and gross proceeds for the sold security. Further, the broker must adjust the basis of the purchased security by the amount of the disallowed loss when reporting the eventual sale of the purchased security.

Despite comments requesting exceptions to the wash sale rules for de minimis amounts and wash sales triggered by automatic dividend reinvestments, the proposed regulations do not provide any such exceptions.

Time and Manner of Making the Average Cost Election

Under the proposed regulations, a taxpayer elects the average cost method for covered securities by notifying the custodian or other agent for the taxpayer's account in writing. The taxpayer must make a separate election for each account for which average cost is permissible. Taxpayers may elect average cost at any time, effective for sales after the date of the election. Other than requiring that a taxpayer notify a custodian or agent in writing of an election to use average cost, the proposed regulations do not specify how a taxpayer must communicate a basis determination method.

The current regulations, which require a taxpayer to elect average cost on an income tax return for the first taxable year the taxpayer wants the election to apply, continue to apply for non-covered securities.

Revocation of Average Cost Election

A taxpayer may revoke the average cost election by the earlier of one year from the date of making the election or the first sale or other disposition of the stock following the election. A broker may choose to extend the one-year period but no later than the first sale. The purpose of this rule is to minimize broker recordkeeping requirements. A revocation applies to all identical stock in an account and is effective when the taxpayer notifies the broker or other custodian of the revocation.

Change from Average Cost Method

The proposed regulations permit a taxpayer to change from the average cost method to another permissible method at any time. For shares acquired on or after January 1, 2012, a change in basis method applies to identical stock held in the same account. For shares acquired before January 1, 2012, a change in basis method applies to all identical stock the taxpayer holds in all accounts. Unless the taxpayer revokes an average cost election, any change from average cost will apply prospectively only.

If a taxpayer changes from average cost to another basis determination method for any reason (other than a revocation of the election), the basis of each share of stock immediately after the change is the same as the basis immediately before the change.

The proposed regulations do not limit the number of times or frequency that a taxpayer may change basis determination methods.

The proposed regulations clarify that a change in basis determination method is a change in method of accounting to which the provisions of sections 446 and 481 apply. A taxpayer may change its basis determination method by obtaining the consent of the Commissioner under applicable administrative procedures. The IRS may publish additional guidance of general applicability that provides broad consent for taxpayers to change basis determination methods.

Applying Average Cost on Account by Account Basis

The proposed regulations do not define the term “account.” Rather, the IRS notes that the proposed regulations prescribe when stock must be treated as held in separate accounts and the result of that treatment.

An average cost election applies to all identical RIC stock in an account. For sales or other dispositions of stock after 2011, a taxpayer may use different basis determination methods for identical stock held in two separate accounts, even if held by the same broker. For sales or other dispositions of RIC stock before 2012 for which a taxpayer has used average cost, the current rules continue to apply – the taxpayer must use average cost for identical stock held in separate accounts.

Unless the broker makes a single-account election (discussed below), RIC stock that a taxpayer acquires before January 1, 2012, is treated as held in a separate account from any stock acquired on or after that date. Further, any stock that is a covered security is treated as held in a separate account from any stock that is a non-covered security regardless of when acquired.

Single-Account Election

A RIC may make a single-account election to treat identical RIC stock held in separate accounts for which the taxpayer has elected to use average cost as held in a single account. If a broker holds the stock as a nominee, the broker, and not the RIC, makes the election. The single-account election is irrevocable.

A RIC or broker may make a single-account election only for stock for which it has accurate basis information. A RIC or broker has accurate basis information if the RIC or broker neither knows nor has reason to know that the basis information is inaccurate. Stock for which accurate basis information is unavailable may not be included in the single-account election and must be treated as held in a separate account.

Once a RIC or broker makes a single-account election, it applies to all identical stock that is a covered security that a taxpayer later acquires in an account. If a taxpayer later acquires identical stock in that account that is a non-covered security, the RIC or broker may make another single-account election if the RIC or broker has accurate basis information for the non-covered security. A RIC or broker may make a single-account election for some taxpayers and not others, and they also may make the election for some identical stocks held for a taxpayer and not for other stocks.

Under the proposed regulations, a RIC or broker makes the single-account election by clearly noting it on its books and records. The books and records must reflect the date of the election; the taxpayer's name, account number, and taxpayer identification number; the stock subject to the election; and the taxpayer's basis in the stock. The books and records must be provided to the taxpayer upon request. A RIC or broker must use reasonable means to notify a taxpayer of a single-account election; this may include mailings, circulars, and electronic mail, and may be sent separately to the taxpayer or included with the taxpayer's account statement. The notice must identify the securities subject to the single-account election and advise the taxpayer that the stock will be treated as covered securities without regard to the acquisition date.

FIFO and Specific Identification

Consistent with current law, [10] the proposed regulations provide that a taxpayer makes an adequate identification of stock at the time of sale, transfer, delivery, or distribution if the taxpayer identifies the stock no later than the earlier of the settlement date or the time for settlement under Securities and Exchange Commission regulations. Taxpayers may establish a lot selection method, such as highest in, first out (HIFO), by standing order.

The proposed regulations do not designate how taxpayers must communicate lot selection to brokers. Any reasonable method of communication, including electronic and oral communication, is permissible.

The proposed regulations do not amend the current requirement under Treas. Reg. § 1.1012-1(c)(i)(b) and (ii)(b), which requires a broker or agent to provide written confirmation of the sale of stock a taxpayer has specifically identified within a reasonable time after sale. This rule ensures that taxpayers receive necessary information in a timely manner. What is reasonable depends on the facts and circumstances. The proposed regulations do clarify that a written confirmation, record, document, instruction, or advice includes a writing in electronic format.

Reporting to S Corporations

Section 6045(g)(4) requires brokers to report sales by customers that are S corporations of covered securities acquired on or after January 1, 2012. To comply with this new requirement, the proposed regulations exclude S corporations from the list of exempt Form 1099-B recipients, but only for sales of covered securities acquired on or after January 1, 2012. The proposed regulations also restrict a broker's ability to rely solely on the name of the customer to determine whether the customer is a corporation exempt from reporting.

The IRS currently is considering modifications to Form W-9, as requested by commentators, which would facilitate a customer's statement to its broker of its current election to be taxed as an S corporation. The proposed regulations do not require brokers to solicit or re-solicit Forms W-9 from all existing corporate customers. If, however, a broker does not have actual knowledge that a corporate customer is taxed as a C corporation or is otherwise exempt, the broker must request a Form W-9 exemption certificate or else must make a return of information for any sales by the corporation of covered securities acquired on or after January 1, 2012. The preamble to the proposed regulations notes that brokers who wish to report other Form 1099 information (such as interest and dividends) on a composite statement to S corporations may do so, but the proposed regulations do not directly address this issue, because there is no penalty for the act of filing a return that is not required.

Reporting to Trust Interest Holders in a WHFIT

The proposed regulations clarify that the sale of a trust interest in a widely held fixed investment trust ("WHFIT") by a trust interest holder is required to be reported under section 6045(a). A trustee or middleman is deemed to meet the cost basis reporting requirements of section 6045(g), however, by complying with the WHFIT rules in Treas. Reg. § 1.671-5. The government requests additional comments on whether any basis reporting rules are needed in addition to those provided under Treas. Reg. § 1.671-5 to accommodate trust interest holders in a WHFIT.

Due Date for Payee Statements Furnished in a Consolidated Reporting Statement

As part of the Energy Improvement and Extension Act of 2008, the information reporting

deadline was extended from January 31 to February 15 for statements required under section 6045 of the Internal Revenue Code (IRS Form 1099-B), as well as any statement sent to a customer as part of a “consolidated reporting statement,” to be defined in regulations. The proposed regulations define “consolidated reporting statement” as a grouping of statements furnished to the same customer or same group of customers on the same date, whether or not the statements are furnished with respect to the same or different accounts or transactions. The grouping of statements must be limited to those furnished to the customer based on the same relationship as the statement furnished under section 6045 (for example, as broker or payor) and not as a result of any other relationship between the parties (such as debtor to creditor or employer to employee).

Specifically, the following forms may be furnished in a consolidated reporting statement with a statement required under section 6045: Form 1099-DIV (Dividends and Distributions); Form 1099-INT (Interest Income); Form 1099-MISC (Miscellaneous Income); Form 1099-OID (Original Issue Discount); Form 1099- PATR (Taxable Distributions Received from Cooperatives); Form 1099-Q (Payments from Qualified Education Programs (under Sections 529 and 530)); Form 1099-R (Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.); Form 3921 (Exercise of an Incentive Stock Option under Section 422(b)); Form 3922 (Transfer of Stock Acquired Through an Employee Stock Purchase Plan under Section 423(c)); and Form 5498 (IRA Contribution Information). The IRS requests comments regarding whether any other forms should be included in the definition of consolidated reporting statement.

The proposed regulations also clarify that a broker may treat any customer as receiving a required statement under section 6045 if the customer has an account for which a Form 1099-B would be required to be furnished under section 6045 had a sale occurred during the year. Thus, the February 15 reporting deadline applies to the IRS Forms listed above that are included in a consolidated reporting statement, even if the customer does not receive a Form 1099-B for that year.

Reporting Required in Connection with Transfers of Securities

The proposed regulations presume that every transfer of custody from an applicable person to a broker or other custodian of any share of stock in a corporation (other than a RIC) on or after January 1, 2011, and every such transfer of any share in a RIC on or after January 1, 2012, that is not a sale, is a transfer of a covered security subject to cost basis reporting. Thus, a transfer statement must be furnished for every transfer, including transfers of non-covered securities. If the transferred security is a non-covered security, the transfer statement is not required to include any information other than an indication that the security transferred is a non-covered security. A separate statement must be furnished for each security and, if transferring the same security acquired on different dates or at different prices, for each acquisition. Each transfer statement must be furnished no later than fifteen days after the date of settlement for the transfer.

The duty to furnish the transfer statement falls on the person effecting the transfer of the security if the person is an applicable person. An "applicable person" is defined as a broker within the meaning of Treas. Reg. § 1.6045-1(a)(1) (generally, any person standing ready to effect a sale of securities), any person that acts as a custodian of securities in the ordinary course of a trade or business, any issuer of securities, and any agent of these persons. An applicable person does not include the beneficial owner of the securities, any governmental unit or agency or instrumentality of a governmental unit with respect to escheated securities, or any person that acts solely as a clearing house for the transfer. For securities held by direct registration with the issuer, including certificated shares, the person effecting the transfer is the issuer or its transfer agent. For securities held in street name, the person effecting the transfer is the broker or other firm carrying the securities.

The proposed regulations also impose the duty to furnish a transfer statement on issuers, transfer agents, professional custodians, and other applicable persons that may not effect sales. For these applicable persons, this duty is limited to receiving the statement when receiving custody of transferred securities and then retransmitting the information on the statement when transferring custody of those securities to a broker. The proposed regulations do not impose a duty on those that do not effect sales to update basis in response to adjustments announced by issuers regarding corporate actions or to compute basis by average cost. The IRS and Treasury Department specifically request further comments regarding the scope of the transfer statement requirement.

The transfer statement must be furnished in writing unless both the furnishing party and the receiving party agree to a different format or method prior to the transfer. No official form or format for the transfer statement is required; rather, the proposed regulations set forth certain information that must be provided on the statement. The proposed regulations permit flexibility in the format and method by which information is furnished pursuant to agreement by the parties, though the government requests further comment regarding these issues.

Under the proposed regulations, a transfer statement [11] must include:

- The date the statement is furnished and the date of any previous statement with respect to the same transfer;
- The name, address, and telephone number of the applicable person furnishing the statement;
- The name, address, and telephone number of the broker receiving custody of the security;
- The name, address, telephone number, taxpayer identification number, and account number of the beneficial owner or owners of the security prior to the transfer and, if different, the beneficial owner or owners after the transfer;
- The CUSIP number of the security transferred (if applicable), quantity of shares or units, security symbol (if applicable), lot numbers (if applicable), and classification of the security (e.g., classification as stock);
- The date the transfer was initiated and the settlement date of the transfer (if known); and

- The total adjusted basis of the security, the original acquisition date of the security, and the date for computing whether any gain or loss with respect to the security is long-term or short-term upon the subsequent sale. If organizational actions reportable on an issuer statement are taken into account in determining adjusted basis, the transfer statement should include the identifying number of the last issuer statement taken into account to indicate the organizational action identified, plus an identification and description of any other organizational actions reflected on the transfer statement that the applicable person did not derive from an issuer statement. If the basis of the transferred security is determined using average cost, any securities acquired more than five years prior to the transfer may be reported on a single statement on which the original acquisition date is reported as "various."

Additional information is not required by the proposed regulations but may be provided on the transfer statement.

If an applicable person furnishing a transfer statement later receives a statement for an earlier transfer that reports that the transferred securities are covered securities and includes information inconsistent with the subsequent transfer statement, the applicable person must furnish a corrected statement to correct the inconsistent information within fifteen days following the receipt of the prior transfer statement.

In the case of a transfer of less than the entire position of a security acquired in an account on different dates or at different prices, the transfer statement must report the transfer on a FIFO basis within the account, unless the customer notifies the applicable person furnishing the transfer statement by means of making an adequate and timely identification of the shares the customer wishes to transfer.

When reporting the transfer of a covered security, a broker or other applicable person providing the transfer statement must take into account all information reported on any transfer statement received in connection with a previous transfer of the security to its custody, unless the broker knows that the information presented on the previous transfer statement is incorrect.

Reporting Required for Transfers of Gifted and Inherited Shares

The proposed regulations provide that gifted and inherited securities that were covered securities in the account of the donor or decedent remain covered securities when transferred to the recipient's account and are accompanied by a transfer statement. Despite comments to the contrary, the IRS states in the preamble that transfers of gifted and inherited shares "fall within the plain language of the statute," and therefore are not excluded from the transfer reporting requirements. The IRS believes that the proposed regulations provide workable rules to minimize complexity.

When covered securities are transferred from a decedent, the proposed regulations require the transfer statement to indicate that the securities are inherited. The transfer statement also must report the date of death as the acquisition date and must report adjusted basis in accordance with the instructions and valuations provided by an authorized representative of the estate. The selling broker must later take these basis adjustments into account in reporting adjusted basis upon the subsequent sale or other disposition of the inherited securities.

The applicable person effecting the transfer may rely upon the instructions and valuations provided by the authorized estate representative. If the applicable person does not receive instructions and valuations from the authorized estate representative, the applicable person must request the information before preparing the transfer statement. If the information is not provided before the transfer statement is prepared, the transfer statement must indicate that the transfer consists of an inherited security but must report the security as a non-covered security. If the information is later provided, the applicable person must send a corrected transfer statement.

When covered securities are transferred as a gift, the transfer statement must indicate that the transfer consists of gifted shares and must state the adjusted basis of the securities in the hands of the donor and the donor's original acquisition date of the securities. The transfer statement also must report the date of the gift (if known) and the fair market value of the gift on that date (if known or readily ascertainable). If the gifted securities are subsequently transferred to a different account of the same owner, the applicable person must include the date of the gift on the subsequent transfer statement and the fair market value of the securities as of the date of the gift (if known or readily ascertainable at the time). The selling broker must later apply the relevant basis rules for gifts when reporting basis upon a subsequent sale or other disposition of these securities. If a selling broker does not receive a transfer statement with the fair market value of the gifted shares as of the date of the gift, and such value is not readily ascertainable, the selling broker must report adjusted basis equal to the gross proceeds from the sale.

The same adjusted-basis-equals-gross-proceeds-from-sale rule applies if the donor's adjusted basis exceeds the shares' fair market value on the date of gift and the shares later are sold for less than the donor's adjusted basis. In this situation, application of the rule effectively disallows the loss that otherwise would be incurred on the sale.

If the request to transfer ownership between different people is silent as to the reason for the transfer, the transfer generally should be treated as a gift.

Reporting of Corporate Actions that Affect Basis

If an organizational action by an issuer affects the basis of a specified security, new section 6045B requires the issuer to file a return with the IRS and to furnish to each nominee a written statement regarding the action. The proposed regulations require a reporting issuer to identify itself and the security on the information return and to provide information about the organizational action and any resulting quantitative effect on the basis. The issuer must assign and report a sequential number determined separately by security for each information report the issuer files.

A domestic or foreign issuer is required to furnish a written statement to each holder of record (or the holder's nominee, if the security is held in the name of someone else, provided such nominee is not the issuer or the issuer's agent) that is not an exempt recipient as of the record date of the corporate action and all subsequent holders of record through the date the issuer furnishes the statement.

The return filing and information statement requirements under section 6045B are waived if an issuer posts a statement with the required information in a readily accessible format in an area of its primary public website dedicated to this purpose by the due date for reporting the organizational action to the IRS and keeps the form accessible to the public. This public reporting relieves the issuer of its duty both to file the return with the IRS and to furnish the statement to its nominees and certificate holders.

An issuer may make reasonable assumptions about facts that cannot be determined prior to this due date, but the issuer must file a corrected return once the facts are determined if necessary to report the correct effect on basis. The proposed regulations expect that an issuer will treat a payment that may be a dividend consistently with its treatment of the payment under the information reporting rules of section 6042(b)(3) and Treas. Reg. § 1.6042-3(c). For example, if an issuer makes a distribution at calendar year-end but is unsure whether the distribution will exceed its earnings and profits for the fiscal year, the distribution should be treated as a dividend, and the issuer is not required to file an issuer return. If the issuer later determines at the close of its fiscal year that this treatment was incorrect, the issuer must determine and report the correct effect on basis. [12]

Penalty Provisions

Under the proposed regulations, brokers generally must adjust basis reported for covered securities to reflect information received on any transfer statement under section 6045A, and information reported by an issuer under section 6045B regarding corporate actions. Any failure to report correct information that arises solely from reliance on these statements is deemed to be due to reasonable cause with respect to the penalties under sections 6721 (failure to file required statements and returns with the IRS) and 6722 (failure to file required statements to payees).

The proposed regulations permit, but do not require, a broker to adjust the reported basis in accordance with information that is not reflected on a transfer statement or issuer statement, including any information the broker has about securities held by the same customer in other accounts with the broker. A broker that takes into account information received from a customer or third party other than information reflected on a transfer statement or issuer statement relies upon such information in good faith (in accordance with existing rules under Treas. Reg. § 301.6724-1(c)(6)) if the broker neither knows nor has reason to know that the information is incorrect.

Proposed Effective Dates and Applicability Dates

The proposed regulations, except as noted below, will take effect when published in the Federal Register as final regulations. The regulations regarding cost basis reporting under section 6045(g) will apply to (1) any share of stock other than RIC stock or DRP stock acquired on or after January 1, 2011; and (2) any share of RIC stock or DRP stock acquired on or after January 1, 2012. The regulations under section 1012 regarding the determination of basis will apply for taxable years beginning after the date that final regulations are published in the Federal Register, except that (1) the proposed regulations permitting the use of average cost for DRPs will apply to DRP stock acquired on or after January 1, 2011; and (2) the proposed regulations under section 1012 regarding the use of average cost for RIC shares will apply to shares acquired, or to sales, exchanges or other dispositions of stock (as the case may be), on or after January 1, 2012.

The regulations regarding transfer statement reporting under section 6045A will apply to (1) transfers of stock other than RIC stock or DRP stock that occur on or after January 1, 2011; and (2) transfers of RIC stock or DRP stock that occur on or after January 1, 2012. The regulations regarding issuer reporting under section 6045B will apply to (1) organizational actions affecting basis of stock other than RIC stock that occur on or after January 1, 2011; and (2) organizational actions affecting basis of RIC stock that occur on or after January 1, 2012.

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endnotes

[1] See Institute Memorandum (24017) to Broker/Dealer Advisory Committee No. 65-09, Bank, Trust and Recordkeeper Advisory Committee No. 54-09, Tax Members No. 34-09, Operations Members No. 28-09, Transfer Agent Advisory Committee No. 92-09, and Small Funds Members No. 72-09, dated December 16, 2009.

[2] This new reporting requirement is effective for securities (other than shares in regulated investment companies, or “RICs”) purchased on or after January 1, 2011, and for RIC shares purchased on or after January 1, 2012.

[3] See Institute Memorandum (24022) to Broker/Dealer Advisory Committee No. 66-09, Bank, Trust and Recordkeeper Advisory Committee No. 55-09, Operations Members No.

29-09, Small Funds Members No. 75-09, Tax Members No. 35-09, and Transfer Agent Advisory Committee No. 93-09, dated December 17, 2009.

[4] The proposed regulations also contain extensive rules regarding the use of the average cost method in connection with corporate dividend reinvestment programs ("DRPs") and the reporting requirements for short sales of stock. Because these provisions generally do not impact RICs, they are not described in detail here.

[5] For purposes of the proposed regulations, securities issued by unit investment trusts (as defined in the Investment Company Act of 1940) are treated as shares of stock.

[6] See Example 6, page 99 of the proposed regulations.

[7] A draft of the Form 1099-B for 2011 is available for viewing and comment on the IRS web site at http://www.irs.gov/pub/irs-dft/f1099b--dft.pdf.

[8] The preamble to the proposed regulations note that the instructions to the tax return will inform taxpayers of their duty, with respect to covered and non-covered securities, to verify the information reported by brokers and to adjust the reported information when necessary to reflect the taxpayer's correct information.

[9] The proposed regulations define "identical stock" as stock having the same Committee on Uniform Security Identification Procedures ("CUSIP") number.

[10] Rev. Rul. 67-436 (1967-2 CB 266) holds that an identification of stock by the time of delivery, which was within four days of the sale date, complied with the requirement to identify stock at the time of the sale or transfer.

[11] These information requirements apply only to transfers of covered securities; transfer statements accompanying non-covered securities must report only that the security is a non-covered security.

[12] See Example 2(iii), p. 128.
