

MEMO# 19613

January 20, 2006

IRS NATIONAL TAXPAYER ADVOCATE'S REPORT TO CONGRESS RECOMMENDS BASIS REPORTING LEGISLATION

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19613] January 20, 2006 TO: OPERATIONS COMMITTEE No. 4-06 BROKER/DEALER ADVISORY COMMITTEE No. 2-06 BANK AND TRUST ADVISORY COMMITTEE No. 3-06 TRANSFER AGENT ADVISORY COMMITTEE No. 5-06 RE: IRS NATIONAL TAXPAYER ADVOCATE'S REPORT TO CONGRESS RECOMMENDS BASIS REPORTING LEGISLATION The IRS National Taxpayer Advocate ("NTA") has released her 2005 Annual Report to Congress ("Report").¹ Among other things, the Report makes legislative recommendations intended to simplify tax reporting and address taxpayer noncompliance. This year's recommendations include the attached proposal to require brokers to track and report cost basis for stocks and mutual funds. Specifically, the NTA recommends that section 6045 of the Internal Revenue Code be amended to: (1) Authorize the IRS to prescribe regulations that require brokers to report information regarding gross proceeds and adjusted basis in connection with the sale of stock and mutual fund shares; and (2) Require financial institutions that hold stock or mutual funds for customers to provide a customer's adjusted basis in transferred shares to a successor financial institution. Although the NTA believes that the IRS has regulatory authority under current law to impose these requirements, she recommends that Congress provide clarification via a statutory amendment. The Report identifies three technical issues associated with cost basis tracking and reporting. The first issue involves complexities created by the various methods of computing 1 Go to <http://www.irs.gov/advocate/article/0,,id=152735,00.html> to read an executive summary and the complete report. 2 tax basis authorized by regulations. The NTA proposes that cost basis for stocks be reported using the first in/first out ("FIFO") method and that basis for mutual funds be reported using the average cost method. Taxpayers would be allowed to elect to use an alternative method by submitting an explanation on their returns. A second issue involves basis reporting where stocks or mutual funds are transferred as a gift or upon death. The broker would need to receive paperwork documenting sufficient details regarding the transfer to continue to track the holder's basis accurately. Finally, the Report anticipates that existing computerized record systems would need to be updated to permit brokers and other financial institutions to track and report adjusted basis of stock and mutual fund shares. Although the NTA recognizes that there would be costs associated with these modifications, she proposes that Congress provide a one-time tax credit to offset the expenses of implementing the proposal's requirements. Lisa Robinson Associate Counsel Attachment (in .pdf format)

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