

MEMO# 4223

November 3, 1992

YEAR-END TAX INFORMATION REPORTING FOR 1992 RETURNS

November 3, 1992 TO: TAX MEMBERS NO. 71-92 ACCOUNTING/TREASURERS MEMBERS NO. 39-92 OPERATIONS MEMBERS NO. 44-92 SEC RULES MEMBERS NO. 57-92 CLOSED-END FUND MEMBERS NO. 42-92 TRANSFER AGENT ADVISORY COMMITTEE NO. 67-92 BROKER/DEALER ADVISORY COMMITTEE NO. 34-92 RE: YEAR-END TAX INFORMATION REPORTING FOR 1992 RETURNS

At a recent meeting of the Broker/Dealer Advisory Committee, a representative of the brokerage industry stated that funds must provide brokers with all year-end tax information for inclusion on IRS Forms 1099 mailed in January 1993 no later than Friday, January 8, 1993. Representatives of the fund industry then observed that it may not be in a shareholder's best interest for fund accountants to be given only one week to properly calculate year-end tax information and report that information to brokers. Nevertheless, the Institute urges funds to make every effort to meet this January 8 deadline since (i) information received by brokers after that date would presumably not be included on 1099s mailed by brokers in January 1993 and (ii) shareholder relations issues may arise when brokers send amended 1099s thereafter, as they are now clearly required to do in accordance with the recently clarified information reporting penalty regulations.

Recent Deadlines for Providing Year-End Tax Information

As you may know, in recent years the deadline for providing brokers with year-end tax information has been pushed to earlier and earlier dates in January. In 1989, for example, representatives of the fund and brokerage industries met and agreed to split January in half, with the funds providing year-end tax information to brokers by January 15 of each following year. Thus, the deadline for providing 1989 tax information to brokers was Monday, January 15, 1990. At a meeting in 1990 to discuss the January 1991 tax reporting season, however, the brokers maintained that they would need three weekends in January to process year-end tax information and that the new deadline would be the Friday before the first of the final three weekends. Thus, the 1990 tax information reporting deadline was Friday, 11/ Among the problems confronted by funds (which have been discussed at earlier meetings with brokers and described in earlier memoranda regarding year-end reporting deadlines) are (i) capital gain reclassifications arising from foreign currency gains or losses, (ii) short-term to long-term and long-term to short-term gain reclassifications for funds with loss deferrals from straddles and mark-to-market gains and losses from section 1256 futures contracts, (iii) application of the wash sale rules, and (iv) the 1989 statutory change requiring funds to accrue dividends to be received on the ex-dividend date.

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January 11, 1991 and the 1991 tax information reporting deadline was Friday, January 10, 1992. As noted above, the deadline for providing 1992 tax information to brokers will be Friday, January 8, 1993 rather than Friday, January 15, 1993, which would be the deadline if the three-weekend rule were

followed. Year-End Tax Reporting Difficulties At least three major problems exist with reporting year-end tax information to broker-sold accounts by January 31. First, the funds confront numerous complexities in properly calculating the tax information, some of which cannot be resolved by mid- January.^{1/1} Second, brokers face time constraints in processing and reporting fund information by January 31 along with tax information for their clients' other securities positions. Third, logistical difficulties result from funds having to report tax information to numerous brokers and from brokers having to collect the data from a large number of funds. Shareholder/Client Relations Reporting to shareholders as corrections all dividend reclassifications received after close of business on January 8 presents potentially serious shareholder and client relations problems. For example, if a fund reclassifies its dividends for 1992 on January 11, 1993, it will be unable to have the revised information included on the shareholders' 1099 DIVs mailed by January 31. Shareholders receiving corrected information after having filed their tax returns can be expected to complain to their brokers, who can in turn be expected to deflect responsibility to the funds for not being "timely" in providing the information. Funds, in turn, may be expected to respond to inquiries that such information was available to brokers on a timely basis. Obligation to Amend 1099 Tax Information In earlier years, it may have been unclear whether brokers had any obligation to inform their customers of "corrected" tax - 2 - information received from funds after the January deadline for providing information to brokers. We understand that in at least some cases, brokers forwarded to their clients "Dear Shareholder" ^{22/} Under the regulations, submissions will be considered regular only if made at intervals of 30 days or less. - 3 - letters prepared by funds to explain why the revised tax information was not included in the 1099s sent in January. It is uncertain the extent to which amended 1099s were sent to shareholders and whether in all cases tax information provided to shareholders matched tax information provided to the IRS. Any remaining uncertainty regarding a broker's obligation to send amended 1099s was removed by the final information reporting penalty regulations issued on December 30, 1991; these regulations provide a detailed definition of the standard of care necessary to avoid the imposition of penalties for failures to provide correct information on, among other things, IRS Forms 1099 sent to shareholders. Pursuant to these regulations, a broker will not be penalized for failure to include correct tax information on 1099s mailed to customers by January 31, where such information must be obtained from another person (such as a mutual fund, some of whose shares the broker holds in street name), so long as the broker sends the customers amended 1099s reflecting the correct information within 30 days after receipt of the correct information or on the earliest date thereafter on which a regular submission^{2/2} of corrections is made. Treas. Reg. Sec. 301.6724-1(d)(1)(ii)(D). Conclusion It is clear that both the broker and the mutual fund industries must continue to work together to provide accurate and timely information to shareholders. The issuance of significant numbers of amended 1099s to brokers' customers is not in the best interest of either the shareholders, the funds or the brokers. A "take it or leave it" position by brokers that funds must provide all tax information by January 8, 1993 does not advance the "common cause." The position by the broker community that the last weekend in January (January 30-31, 1993) must be reserved to process their clients' ordinary monthly statements is totally unacceptable. Broker customers can be told in advance that their January statements will be slightly delayed due to the production of tax information. Everyone should understand and accept this explanation. Finally, in a time period where great emphasis is being placed on quality service by brokers and funds, no benefits will come from reporting incorrect tax information to shareholders. It is costly and inefficient for brokers to impose such overly stringent reporting deadlines on funds that incomplete or inaccurate information is provided. When the information is - 4 - corrected, shareholders may become confused or annoyed, especially if their tax returns have already been filed. If the - 5 - inaccurate information is

not corrected, brokers will be subject to information reporting penalties and investors will be at risk if they are audited by IRS. * * * * We will continue to discuss year-end information reporting procedures with the brokers and keep you informed of any developments. In the meantime, fund groups are urged to make every effort to provide brokers with timely tax information; whenever possible, that information should be provided by January 8, 1993.
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