

Key Concerns

Excerpted from:
**Cost Basis Reporting
Legislation:
Worries & Pitfalls**

A Webinar Presented By:
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Key Areas of Concern Regarding Proposal

- √ Developing software systems to accurately track tax basis
 - Tax lot detail needed due to wash sale and short/long holding period reporting requirements
 - Corporate actions including REIT return of capital adjustments will need to be taken into account
- √ Grandfathering & Averaging
 - Bifurcation of accounts into pre-effective date and post-effective date subaccounts—system constraint concerns
 - Averaging rules only available for open-end funds; transition rule and subsequent taxpayer override
- √ Mismatch risk
 - Corporate actions with no single answer
 - Reporting for fractional shares
 - Single account wash sales versus cross account wash sale basis adjustments
- √ Rapidly approaching effective date

Key Areas of Concern Regarding Proposal-2

- ✓ Tax penalty risks “raise the bar”
 - Both basis reporting and corporate action reporting will be subject to tax penalties applicable to information returns
 - Sec. 6721 imposes a \$50 per return (up to \$250K) for failing to file correct 1099s; Sec. 6722 imposes a separate \$50 per return (up to \$100k) for failing to provide taxpayer with correct 1099s; each penalty is 5% of amount that should have been reported without limit if intentional disregard
- ✓ Corporate actions reporting complexities
 - Some corporate actions have no tax opinion or possible alternative tax treatments
 - Non U.S. stocks and securities routinely have no U.S. tax opinion
 - Generally unclear tax treatment of bankruptcy reorganizations
- ✓ Taxpayer election complexities for basis computations for debt
 - Debt securities are subject to sets of tax rules for original issue discount, market discount, & bond premium that result in adjustments to basis and each taxpayer can make elections that affect the computations (even greater complexities for mortgage-backed securities & foreign currency denominated securities)
- ✓ Difficulties in properly reporting short sales—determining whether a constructive sale has occurred

Other Concerns

- ✓ Broker account transfers
 - Data system mechanics and compatibility issues
- ✓ Treatment of basis adjustments for gifts
- ✓ Corporate action reporting by issuers and central repository
 - Issuers will be subject to penalty risk
 - Detail left to be addressed in IRS guidance—when?
 - Will corporate issuer data provided be adequate for broker reporting?
 - How or will central repository be implemented?

Conclusions—Difficult Concerns Remain

- ✓ Basis reporting raises many complexities with little time to prepare and significant penalty risks
- ✓ IRS details will be critical given that the impact of some corporate action events on basis will not be clear
- ✓ Brokers will need to determine whether their data systems do and can provide the necessary information to make adjusted basis calculations for holdings—they will also need to address account transfer requirements
- ✓ Brokers and issuers will need to further scrutinize corporate action events for tax accuracy due to potential Form 1099 penalty risks
- ✓ Both holders and the IRS will need ways to independently verify the accuracy of broker Form 1099 basis reporting or they will be forced to live with whatever brokers provide

How is the Industry Responding?

√ Many Firms are Preparing Now

- Large # of RFPs
- Build vs. buy evaluation
- Working with clearing firms/software vendors
- Current customers expanding usage of system
- New implementations under way
 - √ Utilizing Phased Approach
 - Phase 1 - Populate missing cost basis data
 - Phase 2 - Maintain cost basis going forward
 - √ Timeline to fully implement solution can take 3 - 12 months depending upon approach

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Stevie has extensive experience regarding the taxation of financial products and corporate actions and led GainsKeeper's development of its new straddle engine. Before joining GainsKeeper, Stevie was senior tax editor for Capital Changes. She was formerly a tax partner at the law firms Katten Muchin Rosenman and Baker & McKenzie. Ms. Conlon is a prior chair of the American Bar Association Tax Section's Financial Transactions Committee. Stevie is the lead author of the tax law treatise Principles of Financial Derivatives: U.S. & International Taxation, and a member of the advisory boards for the Journal of Taxation of Financial Products and Derivatives Report. She is also the author of over 30 bylined articles focusing on the taxation of capital market financial products and has regularly been quoted in prominent industry publications & the financial press. Ms. Conlon is a member of the New York & Illinois bars and a CPA.

