

## Jan 20th 2010 CBR Proposed Regs Webinar Q&A Recap

### Lots, Lot Relief, 1099s

**QUESTION:** Can a customer use a different lot relief method than the method used by the broker in completing the 1099?

**ANSWER:** No—the proposed regulations impose a consistency requirement that the customer must use the same method that the broker uses on Form 1099.

**QUESTION:** What will customers do if the 1099 cost basis number doesn't match their calculation due to cross account wash sale or other differences?

**ANSWER:** The proposed regulations do not address potential “matching error” issues when a customer reports on Schedule D cost basis numbers that are different from those reported on Form 1099 by brokers. We have suggested that IRS should create a form to assist taxpayers in reconciling such differences.

**QUESTION:** How will customers terminate their use of averaging?

**ANSWER:** A customer would notify his broker and would need to file a change in accounting method form with the IRS (the preamble to the proposed regulations suggests that the IRS may provide advance consent in many cases) and would need to make Sec. 481 adjustments due to the change in method, which could be complex and difficult for individual customers to follow.

**QUESTION:** Will investors keep all of their current choices to calculate basis?

**ANSWER:** Yes—except “double category” averaging is eliminated (single category averaging is retained). It does not seem that very many people (if any) had elected double category averaging.

**QUESTION:** Is a broker required to have average cost as an available method for customers?

**ANSWER:** Yes, brokers must support a customer's election and a customer can elect averaging for mutual fund and dividend reinvestment plan (DRP) shares.

**QUESTION:** How many different lot methods are there under the proposed rules?

**ORIGINAL ANSWER:** There are three basic methods, although one of the three methods (specific ID has so many variations that it could be considered many methods): First-in, first-out (FIFO); Specific ID (which can be used to select lots under a variety of different methods such as lowest-in, first-out or highest-in, first-out); Averaging (only available for mutual fund shares including most ETFs and DRP stock).

**QUESTION: Is lot selection now tied at the lot level, versus account level?**

**ANSWER:** Lot selection was always determined at the lot level under existing law.

**QUESTION: With respect to LOTS...is there any proposed language discussing the ability for the shareholder to combine lots to determine a price?**

**ANSWER:** No. Remember, except for mutual fund and DRP shares, basis cannot be averaged under the tax law. Thus, lots cannot generally be combined.

**QUESTION: Is lot liquidation specified per lot or per customer account?**

**ANSWER:** Per lot, although a customer could provide a standing order that “all stocks” in my account will be sold “Highest-In, First-out,” for example.

**QUESTION: Regarding the 'simplification' allowed by the IRS with respect to multiple fills/lots per buy/sell, can you provide some detail here?**

**ANSWER:** In 1988, the IRS issued Private Letter Ruling 8852028 (Sep. 29, 1988) permitting a broker to report multiple trades occurring on the same day in connection with a limit order to be aggregated. A Private Letter Ruling can only be relied on by the taxpayer that requested it. The discussion related to whether the IRS would consider expanding this sort of permitted aggregation to simplify the reporting of such multiple lots/fills.

**QUESTION: If the broker's default is average cost, can the broker make this election without the shareholder's written consent?**

**ANSWER:** Yes under Prop. Reg. Sec. 1.1012-1(e)(2)(i). However, the customer can elect an alternate method and the broker must then use the customer elected method. Note, however, that as drafted Prop. Reg. Sec. 1.1012-1(e)(11)(i) permits a broker to make a single account election (to average together covered and noncovered shares) only if the customer has made the averaging election. Based on published statements of IRS officials, we anticipate that this position may be changed.

**QUESTION: Regarding accounts with DRPs, is the customer allowed to select average cost basis for shares acquired through DRP and FIFO or something for the shares of the same CUSIP acquired via hard purchase?**

**ANSWER:** Yes. The shares within the DRP are treated as separate from the identical CUSIP shares that are outside of the DRP.

**QUESTION:** Can a client "revoke" a relief method other than average cost, or are all other relief methods considered a "change" and prospectively applied?

**ANSWER:** A relief method cannot be retroactively revoked after the settlement date for the shares sold. Except with respect to shares subject to an existing averaging election, a client can prospectively change lot relief methods at any time. Such changes are not considered a method change requiring IRS consent.

**QUESTION:** Is Transfer paperwork required for transfers between internal accounts with identical owners? What about from a single to joint and vice versa? If a firm does cost basis for covered and uncovered on a stock, how is the 1099 filled out? Do they check both covered and uncovered in box 5? Can the same 1099 for covered and uncovered be used if cost basis is reported on both if so are both boxes checked in the 1099 box 5?

**ANSWER:** No—the proposed regulations provide that the transfer statement is deemed to have been furnished in such a case provided that the required information for cost basis reporting, including any related adjustments, is incorporated into the records for the recipient account. Separate Forms 1099 are required for covered and uncovered securities.

**QUESTION:** Is the gain or loss in box 7 computed before or after the wash sale deferral?

**ANSWER:** The draft form does not include draft instructions so the answer is not clear. However, the description for box 7 is "reported gain or loss." Presumably reported gain or loss would have already been adjusted for any disallowed wash sale loss because such wash sale loss cannot be reported on the recipient's tax return. The disallowed wash sale loss is separately reported in box 5, and any basis adjustment is taken into account in determining reported gain or loss.

**QUESTION:** Who supplies the 1099? Custodians and Brokers? If Brokers do, is it the "clearing firm" or does the "introducing firm" supply this 1099?

**ANSWER:** Existing rules and conventions would presumably apply to determine who supplies the 1099. Presumably it would typically be the clearing firm rather than the introducing firm.

**QUESTION:** If an account has 500 sales throughout the year across many different securities, every sale needs its own 1099 so client could receive at a minimum a 500 page 1099? Or are you saying that the 1099 can be done at summary level with the concept of all securities that generated LT can be summed into one 1099, and all securities that generated ST can be summed into one 1099, etc.?

**ANSWER:** 500 separate sales would be reported. This would typically be done on a single "consolidated reporting statement" that would include at least 500 different lines. As described during the webinar, each sale might be broken down into three or four separate 1099 reportable sales due to the short-term/long-term and covered/noncovered security boxes.

**QUESTION:** Could you clarify more about Corporate Action reporting in regards to how it effects Cost Basis on a 1099-B and what was meant by Corporate Action reporting in regards to the Corporate Action ID number, etc.?

**ANSWER:** Prop. Reg. 1.6045B-1(f) includes examples of reportable corporate actions, including the distribution of stock to shareholders and a cash dividend that resulted in a return of capital basis adjustment. The issuer must include a corporate action identification number when it publishes or delivers its corporate action return or statement. Prop. Reg. 1.6045-1(d)(6)(i) requires brokers to take into account any basis adjustment resulting from an issuer corporate statement. The corporate action identification number must be listed by the broker on any transfer statement.

## Foreign Reporting

**QUESTION:** Do you feel the IRS has considered the affect of the proposals on QI's that are based outside North America? There is a real danger that European institutions will refuse to service US persons. We've seen very little in the media about this.

**ANSWER:** Comments were received by the IRS regarding concerns relating to QIs and their ability and the appropriateness of reporting relating to non-U.S. issued securities. The proposed regulations provide for including non-U.S. payors and non-U.S. middlemen to the extent provided in a withholding agreement between the IRS and a QI, and the preamble states that the Treasury Department and the IRS expect that such agreements will generally provide that a broker that is a party to such an agreement will have the same broker reporting responsibilities as U.S. payors and middlemen. The preamble requests comments regarding the usefulness of information so received, the costs of compliance, and other potential effects of such a requirement in a withholding agreement.

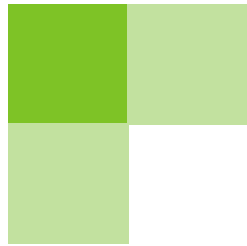
**QUESTION:** How does the IRS/Treasury expect transfer information to be transmitted when the transfer is international? (e.g. ClearStream in Europe or CDS in Canada). Also, how does the IRS expect to be able to apply this to Qualified Intermediaries when they deal with so many foreign bodies not under IRS rule? Also, when the volume of 1099B transaction is so minimal, the maintenance of such a complex system is incredible for the value received.

**ANSWER:** See previous answer.

## Account Transfers, Statements

**QUESTION:** What if a broker receives transferred shares but, after the 15 days, does not receive a transfer statement or receives an incomplete statement?

**ANSWER:** The broker can treat the security as noncovered and is not required to report basis information if and when it delivers a 1099 when that security is sold. However, if the broker later receives a CBRS transfer statement (after the 15 day period has expired), the broker must treat the security as covered and report its adjusted basis when sold or transferred. If the broker has already filed a 1099, a corrected 1099 must be filed.



**QUESTION: Is an electronic file transfer considered a "transfer statement"?**

**ANSWER:** Yes but only if both parties agree.

**QUESTION: Are noncovered securities still required to the new reporting for transfers of ownership, or is it just new purchases after the effective date? Once the transfer occurs the account, is the investment now considered noncovered as theirs is new ownership?**

**ANSWER:** Yes—noncovered securities are subject to transfer reporting but the reporting does not include basis information. No—transferring a security from one account with one broker to another account with a different broker does not change its status as noncovered or covered.

**QUESTION: If an Issuer-Agent is requested to transfer some but not all DRP shares to broker, how will basis of these shares be reported on the transfer statement to broker?**

**ANSWER:** Presumably, the issuer-agent will need to provide the broker with a completed transfer statement for the transferred DRP shares that includes the basis of the securities transferred.

**QUESTION: Are transfers, ROC and corporate action basis adjustments reportable to the IRS or only bookkeeping transactions on the asset for sale purposes?**

**ANSWER:** The issuer must report ROC and corporate actions with the quantitative effect on basis to the IRS and holders. Transfers statements are provided by and to brokers and middlemen.

**QUESTION: On transfer statements—If transferring from an exempt recipient account, are we required to send the cost basis, or can we send a transfer statement which states that the account is a noncovered account?**

**ANSWER:** There is no exception in the proposed regulations relating to the status of the account holder as an exempt recipient. Thus a transfer statement would be required with the related basis information. This requirement seems broad and comments are likely.

**QUESTION: Will there be a "special" transfer statement format?**

**ANSWER:** There is no specific format under the proposed regulations and they permit great flexibility provided the parties agree and the required information is provided.

**QUESTION:** You said that transfer agents might be surprised by how much they are affected, but I'm having trouble coming up with such scenarios. For example, if a client holds shares at broker 1 and transfers an account to broker 2, assuming the securities are held in street name through DTCC, then there is no change on the books of the transfer agent. I would see the transfer rules as applying to brokers 1 & 2 rather than to the transfer agent. What scenarios are there other than certificate holders where this would apply?

**ANSWER:** Many corporations use nonbroker transfer agents to maintain shareholder accounts for stock held by employees under stock purchase plans prior to vesting. Those transfer agents may then transfer the stock to the employee's brokerage account once it is vested. Another similar scenario could be employer stock distributed to employees out of a pension plan. Or a transfer agent may be used for stock in a closely-held corporation, such as a REIT that is not publicly traded.

**QUESTION:** Are there any details in the new guidelines regarding any mandatory reporting in trade confirmations?

**ANSWER:** Yes. The proposed regulations clarify that in order to use a lot relief method other than FIFO, the confirmation must reference the lot sold or the lot relief method/standing order used.

## Death & Gift Transfers

**QUESTION:** If shares transferred are uncovered and due to death or private sale, are these shares now covered in the receiving account since you now have basis?

**ANSWER:** Yes. The proposed regulations require basis reporting and transfer statements in connection with inheritance and gifted shares.

**QUESTION:** If a transfer request is submitted on pre-effective date shares, do the shares become covered in the recipient's account or will those shares remain noncovered until the recipient sells them?

**ANSWER:** Shares generally remain noncovered.

**QUESTION:** If a donor gifts a block of shares to multiple recipients, can the average cost of the entire block be assigned to each recipient in a single lot or do individual lots have to be assigned to each recipient?

**ANSWER:** No—the basis rules do not generally permit averaging of basis (other than in the case of mutual fund and DRP shares).

## Additional Questions

**QUESTION:** Is the effective date likely to be extended?

**ANSWER:** The law does not readily permit an extension of the effective date.

**QUESTION:** What do you think will be in scope in 2011 vs. 2012? Will some of the current timeline requirements be pushed back? What is the likelihood of the IRS providing penalty relief for 2011?

**ANSWER:** Unclear. We have raised these concerns in our comment letter.

**QUESTION:** You mention the proposed regs are 141 pages. Looking at REG-101896-09, that's only 50 pages. Is there another document name you're referring to?

**ANSWER:** I was referring to the double-spaced version of the regulations that was delivered to the Federal Register (and that is available on our website). The version that was published in the Federal Register is only 50 pages.

**QUESTION:** You mentioned a possible IRS ruling on market orders that may allow merger of pricing of multiple prices even if NYSE rules do not allow pricing averaging? Can you give us some insight?

**ANSWER:** In 1988, the IRS issued Private Letter Ruling 8852028 (Sep. 29, 1988) permitting a broker to report multiple trades occurring on the same day in connection with a limit order to be aggregated. A Private Letter Ruling can only be relied on by the taxpayer that requested it. The discussion related to whether the IRS would consider expanding this sort of permitted aggregation to simplify the reporting of such multiple lots/fills.

**QUESTION:** Is the cost basis reported at year end, every year, regardless of there being any activity? Or is it only for purchase year?

**ANSWER:** Cost basis is reported under the IRS rules only when a covered security is sold or transferred. However, many brokers include cost basis information when providing customers information about the securities held in their accounts.

**QUESTION:** What determines what an "account" is? Is it the account number, the registration, or both?

**ANSWER:** The IRS did not address the definition of an account in the proposed regulations.