

Johnson Regina

Notice 2009-17

From: Cynthia Jones [cjones@stai.org]
Sent: Monday, March 02, 2009 4:06 PM
To: Notice Comments
Subject: Notice 2009-17: STA comment letter

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAR 3 2009

Attachments: 2009-03 STA Comment Letter on IRS Notice 2009-17.doc



2009-03 STA
Comment Letter on .

The Securities Transfer Association appreciates the opportunity to comment on Notice 2009-17. Comments are attached. Please confirm receipt of the attachment.

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THE STA

SECURITIES TRANSFER ASSOCIATION, INC.

March 2, 2009

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Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-17).
Room 5203
P O Box 7604 Ben Franklin Station
Washington DC 20044
Attn: Stephen Schaeffer

Re: IRS Notice 2009-17

Dear Mr. Schaeffer:

The Securities Transfer Association (“STA”) appreciates the opportunity to comment on the questions posed by the IRS Notice referenced above. The STA is the professional association of transfer agents. Founded in 1911, the STA membership of over 150 transfer agents maintain records in the aggregate of more than 150,000,000 registered shareholders on behalf of more than 15,000 issuers. The STA supports the regulation that will require basis reporting being provided to shareholders believing it to be an important service. Although the STA has both equity transfer agents and mutual fund transfer agents among its members, the equity transfer agent STA members perform distinctly different functions than broker dealers or mutual fund transfer agents, and have some unique and specific concerns. Our comments, specific to equity transfer agent members, follow:

1 and 2: How to determine who is a “middleman” subject to the broker reporting and transfer reporting statement requirements and how to minimize duplication of reporting by multiple brokers: Also, who, in addition to brokers, should be treated as “applicable persons” subject to the transfer reporting requirements: The STA believes that any entity that holds securities on its books and records

should be subject to the regulation and be required to maintain basis and pass it to others as necessary. This would include even transfer agents that do not normally have tax reporting obligations. The STA recommends that the IRS and Treasury issue clarification on this matter. Absent clarification, the STA is concerned that some transfer agents (who do not normally issue tax forms), may not consider themselves subject to the regulation, which could cause difficulty with compliance. We offer two examples: 1) a shareholder buys post effective date shares through broker A. Subsequently the shareholder asks for his shares to be held on the books of the issuer, either in certificate or book entry form. Broker A moves the shares to a non covered agent who cannot receive or store basis, believing it is not required to. Subsequent to that, the shareholder decides to sell the shares through broker B. The agent moves the shares to broker B, but has no basis information to give that broker. Another example of a problem would be the issuer who moves his business from a non covered agent to a covered one, and the new agent would get no conversion records containing basis for any shareholder. Conversely, the issuer could move his business from a covered agent to a non-covered one, (without the capability to record or store basis), with the result that all the cost basis information would be lost. Regarding the issue of minimizing duplication of reporting by multiple brokers, we believe that whoever has the obligation to issue form 1099B, should do the reporting.

3: No comment

4: How to ensure that customers are adequately informed of the broker's default basis determination method and that brokers are adequately notified of a customer's election of a different acceptable method for an account: STA members envision using a number of methods to inform customers of the default basis determination method, including websites, the Plan Prospectus for Dividend Reinvest Plans, statements and advices, and instructions on transfer forms sent to shareholders. Agents should utilize these methods as appropriate to their businesses and capabilities. Shareholders should only be able to override the agent's default method by making the election at the time the sale is requested. We are aware that the brokerage industry might prefer the election to be made when the account is opened, but that does not work well for the equity transfer agent community. Brokers have a formal new account opening process. Equity transfer agents do not have any direct relationship with shareholders, with the exception of Dividend Reinvestment or Direct Stock Purchase plans.

5: How to facilitate customer elections of acceptable basis determination methods, including average cost basis, for an account to maximize customer flexibility and minimize broker burden: The STA, after examining the use of average cost for Dividend Reinvest Plans, has identified a number of complexities which make it less attractive, and in the opinion of our membership, unworkable. These complexities include the fact that the average cost regulations state that average cost may not be used with certificated shares. However, shareholders, may, at any time, deposit certificates into their Plan, or issue certificates from the Plan. Additionally, although the STA Operations Committee has been focused on solving certain issues with the use of average cost initially forwarded to Treasury in our issues list last December, no workable solutions to these issues have been found. The STA is also concerned that as the regulation is

presently written, the agent or Plan Administrator may choose to use average cost as a default, or may choose not to do so. We are concerned that if an issuer leaves one transfer agent, that provided average cost, and moves to an agent that does not choose to provide it as the default method, that investors would be negatively impacted. After much analysis by our members, the STA believes that average cost does not work for Dividend Reinvestment Plans, and that agents should not be required to provide it, even if requested by the investor. The STA will accordingly be recommending to its members that average cost not be used as a default. As to the question about facilitating customer elections, we believe that each agent should be able to use the means appropriate for its business and its capabilities, on a firm by firm basis.

6: Whether and under what circumstances a customer may elect to change from the average cost basis method to the first-in first-out or specific identification method and, if so, what cost basis rules and adjustments should apply: As stated in #5 above, the STA now believes average cost is inappropriate for equities, and we believe that the SIFMA organization shares this view.

7: What it means to apply the basis determination conventions on an “account-by-account” basis: The STA believes that this means that agents will consider each account on their file as separate and will look at each account discretely when storing, and adjusting basis. The STA is in favor of this approach. We also think it means that pre-effective date shares will not be taken into account when reporting basis.

8,9,10,11: The STA believes that these issues are included because of some earlier conversations about the complexities of trying to use average cost with equity securities in Dividend Reinvestment Plans. The STA now believes that the use of average cost for equities is not appropriate or workable and has no further comment on these questions.

12: How to ensure that broker reporting on Form 1099-B and customer reporting on Schedule D of Form 1040 are maximally consistent, including whether brokers should report separately for securities subject to basis reporting or report the basis of securities that are not covered securities, for example, securities purchased by their customers prior to 2011. After discussion, the STA believes that only the basis of securities purchased after the effective date of the regulation should be reported to the IRS, as called for by the regulation; there should be no requirement to report basis to the IRS on pre-effective date shares. However, we realize that some agents may provide shareholders with basis for pre-effective date shares as a customer service, and some may accept basis given to them by shareholders for the same reason. The matter is complicated by the fact that shareholders must report on all shares sold during the year on schedule D of Form 1040, regardless of purchase date. The STA believes that agents may wish to provide supplemental information on pre-effective date shares to shareholders, if it is available, as well as information on what lots were sold. However, any supplemental information provided should not be required as part of this regulation, and should be given “safe harbor” from any penalties. Additionally, if for some reason, shareholder provided basis is reported to the IRS, it should be flagged as such.

13: How to ensure consistency between customers making specific identification of securities sold or transferred and broker reporting; As stated earlier, the STA

believes that shareholders must first be informed of the agent's default method of basis calculation. After that, shareholders must make specific identification of the shares to be sold to the agent, at the time of sale. If that occurs, the agent will be able to sell the appropriate lots in accordance with shareholder wishes. A best practice would be for the agent to confirm back to the shareholder the lots sold, so that any discrepancy can be resolved before year end. However, the form of acknowledgement, and the decision as to whether or not to send one, should be left to the agent.

14: How to ensure that reconciliation is possible if broker reporting should differ from customer reporting: Agents can only report the data that resides on their own systems. They have no control over what shareholders report. If a shareholder reports something that does not match the agent's records the shareholder should have documentation to substantiate that report, and should be able to provide that documentation to the IRS. The STA sees this process as similar to what is presently done when reporting discrepancies arise. That is, if the IRS has questions about a return, they contact the taxpayer to obtain an explanation or correction.

15: Whether customers, after a sale, may identify or change the identification of specific stock sold and, if so, for what period of time or by what deadline: The STA is not in favor of allowing shareholders to change the identification of specific stock sold after a sale. Our members believe that the shareholder will be adequately informed of the default method, and will be given instructions on how to proceed if they wish to identify specific tax lots for sale (as stated earlier, at the time of the sale, as the rule presently requires). Absent some sort of error by the agent, which would be corrected timely by the agent, customers should not be able to make this kind of change.

16: The scope of the wash sales exception, including the definition of "identical securities" (including identical options), the wash-sale period, and any de minimis or other exceptions: STA members are in favor of an expansion of the exceptions from having to perform the wash sale adjustment calculation. We wish to point out that in regard to Plan activity, there are certain pre-scheduled types of transactions that can trigger a "technical wash sale" without any action or intent on the part of the shareholder. Examples of this would be a dividend reinvestment within 30 days of a sale, or for plans that allow it, a regularly scheduled automatic cash purchase that occurs within 30 days of a sale. This is a common feature of dividend reinvestment plans. Plan prospectuses generally limit the amount that can be contributed and require that the shareholder establish pre-authorized repetitive instructions in advance that remain in effect until rescinded by the shareholder or until the terms of the plan change. The wash sale rules have been promulgated to prevent intentional and inappropriate recognition of capital losses, and that is not what is happening here. While the shareholder does authorize the sale, we believe that the wash sale is likely unintentional because of the repetitive nature of the purchase transaction that triggered it. It is also likely that the dollar amount would be small, given the existence of plan limits. Having to do the basis adjustment associated with these "technical wash sales" complicates the calculation of basis by computer systems, and makes the results more difficult to explain to the shareholder by service representatives. The STA recommends that these automatic, prescheduled transactions be excluded from consideration for wash sale adjustments. Additionally, the STA

recommends a general exemption for calculating and reporting basis adjustments for de minimis amounts stemming from the sales of any fractional shares or for any sale of shares yielding less than \$100.00.

17 and 18: No comment

19: How to address mechanical issues relating to the computation of basis, such as adjustments for debt securities...., gift-related adjustments, death-related adjustments, section 1043 basis rollovers, regulated investment company and real estate investment trust distributions representing return of capital ...etc. The STA is particularly concerned with gift and death related scenarios. As stated in our letter to Jeanne Falstrom Ross, dated January 29th, there is a very critical issue related to these scenarios.

“The issue: The majority of transactions processed by transfer agents involve the movement of shares between the agents and brokers, through the Depository Trust Company, and our members foresee no problems in passing or receiving and storing basis for post effective date shares in these situations. However, agents also process certain transfers of ownership between the registered accounts on their books. A commonplace example of this would be for an instruction to be submitted directly to the agent to transfer all shares from the account of John Doe to three new accounts in the names of other individuals. The instruction would be received with a medallion signature guarantee, making it in “good order” and subject to the 72 hour Turnaround Rule under the Securities Act of 1934. However, there is no requirement for the party submitting the transfer instruction to include with it either the cause or the effective date of the transfer. As such, the agent does not normally receive sufficient information about the transfer to determine if it was the result of a gift, a death, or a private sale, nor when the event occurred. Because there is no direct relationship between the agent and the shareholder, and there is no requirement to provide either the cause or date of the transfer of ownership, the agent has no way of requiring that the shareholder provide what caused that transfer, and consequently has no ability to determine an accurate cost basis to record for the shares in the new accounts.

Let us examine each of the possible scenarios that would have caused the transfer to the three new accounts. Each assumes the original shares were acquired post effective date.

- 1) John Doe sold his shares in a private sale, not involving a broker, on some date prior to the buyer sending in the shares for transfer. Both the sale date and the purchase price paid for the shares are unknown to the transfer agent. Carrying over the existing basis from the John Doe account would result in the agent reporting incorrect basis at such time as the shares in the new accounts were sold. The long or short term distinction might also be incorrect.
- 2) John Doe is deceased and his shares are being transferred to heirs. We believe that current tax law mandates that the basis of the shares should be either the date of death, or the date six months later. The agent generally has no information about the date of death, and so cannot properly attribute basis to these shares. Again, carrying

over the existing basis to the new shares would result in the agent reporting incorrect basis at such time as the new shares were sold.

- 3) John Doe has made a gift of these shares to three individuals. We believe that current tax law mandates that the basis of the new shares should be the value on the date of the gift, if subsequently sold at a loss, or the original basis if subsequently sold for a gain, or otherwise adjusted due to gift tax liability. In this example, the agent does not know the date of the gift, (or if it is a gift situation at all), and so cannot properly attribute basis to these shares.

STA Suggested Solution: Since the transfer agent does not have any of the information it needs to properly assign an accurate basis to post effective date shares transferred between registered accounts on its books, we believe the best solution would be for the agent to assign no basis at all to the shares in the new accounts. It is perhaps feasible that a code could be assigned to these transfers that would enable the IRS to know why no basis was recorded by the agent for these scenarios. While the transfer agent members of the STA understand their obligation in recording and reporting accurate basis when basis is known, we believe that carrying forward the basis from the donor account in any of these three scenarios would result in flawed compliance with the regulation. The issue discussed in this letter is a very fundamental one, needing feedback and guidance from Treasury and the IRS before our members can undertake any of the necessary programming to enable them to implement the new regulations effective in January of 2011.”

In addition, there are issues pertaining to Employee Stock Purchase Plans that the STA is concerned about. How will brokers and transfer agents be able to track and calculate cost basis on shares transferred from qualified Employee Stock Purchase Plans, when the cost basis calculations require more than just knowing the discounted purchase price of the shares. If the shares are sold within one year from purchase or two years from the beginning of the offering period, a disqualifying disposition occurs. Ordinary income resulting from a disqualifying disposition is added to cost basis. This can only be calculated by knowing the FMV at purchase date and the purchase price. Therefore, transfer agents would have to retain both the purchase price and the FMV at purchase date, calculate the disqualifying disposition income, and add that amount to cost basis when reporting the sale. For shares held beyond the qualifying period, there is a different calculation of ordinary income required, also added to cost basis. The calculation of income on qualifying dispositions is based on the sales proceeds, the discount percentage offered, and the FMV at the beginning of the offering period. These calculations must be performed on a lot-by-lot level. Current transfer agency systems are not equipped to retain that data or perform those calculations. We propose that the IRS permit an indicator to be sent along with the purchase cost of the shares transferred, indicating that the total cost basis of the shares is not determined at time of transfer. If this indicator flows through to the 1099-B, the IRS and shareholder will be alerted that additional calculations may be necessary to determine the total cost basis. A similar situation exists relating to Incentive Stock Options, where the optionee exercises and moves the stock to the transfer agent's books. If the shares are sold within one year from exercise or two

years from grant date, a disqualifying disposition occurs. Ordinary income resulting from a disqualifying disposition is added to cost basis. This can only be calculated by knowing the FMV at exercise date and the sales price. Therefore, transfer agents would have to retain both the exercise price and the FMV at exercise date, calculate the disqualifying disposition income, and add that amount to cost basis when reporting the sale. Beyond the qualifying period, the cost basis reverts to the exercise price. Current transfer agency systems are not equipped to retain that data or perform those calculations. We propose that the IRS permit an indicator to be sent along with the exercise price of the shares transferred, indicating that the total cost basis of the shares is not determined at time of transfer. If this indicator flows through to the 1099-B, the IRS and shareholder will be alerted that additional calculations may be necessary to determine the total cost basis.

20: No comment.

21: What information about the transferring person, the customer, the security transferred, and the underlying lots should be required on the transfer reporting statements? The STA envisions that the transfer reporting statements will generally be an electronic file for larger agents with the following data:

- Covered/uncovered indicator
- Acquisition/effective date
- Reason code if uncovered
- Cost basis source
- Cost basis
- Cost basis method (FIFO, or identified). The STA does not support average cost.
- Transaction #, providing link to shareholder and security information on a previously established account
- Date of last basis adjustment
- Indicator that data is missing upon conversion and that it will be forwarded by prior agent

Equity agents and brokers are discussing the use of an existing system, DTCC's Cost Basis Reporting Service, (CBRS), to pass basis to each other. This system generally passes the basis of tax lots one day after the transfer of shares, by means of a unique identifying number which links the basis information with the share movement. For this reason, it will not be necessary to duplicate the passing of primary information such as shareholder name, account number etc. in this file.

22: Whether fifteen days is the proper period for furnishing transfer reporting statements, and under what circumstances a different time period, if any, should apply: In general, today, when brokers supply basis information to each other when shares and accounts are moved between them, the basis information is passed the day following the share movement. The STA believes that the longer the allowable period, the greater difficulty agents will have in matching the basis to the share movement. We

prefer a shorter period and oppose any longer period than fifteen days, as it could cause problems when files are being converted between agents and problems with tax reporting.

23: Whether the basis determination rules and customer elections governing sales of securities should apply equally to transfers of securities, for example, when a customer transfers some, but not all, holdings of a security to another broker: In the environment of the transfer of equities, these rules cannot apply equally because there are protocols and mechanisms in place when shares are transferred between brokers and agents through a depository that preclude the identification of specific lots. The systems in place do not have this capability. However, if a shareholder goes directly to the transfer agent, it could be handled manually.

24: Whether electronic transfer reporting may be appropriate and, if so, whether a common format should apply: The STA believes that electronic reporting is appropriate and that a common format will be beneficial. The industry will develop a format for those scenarios where it makes sense, as needed, but the format should not be dictated by IRS regulation. It is important to note that formats developed for equities will very likely differ from formats developed for RIC's.

25: Whether brokers and transferring parties may utilize reporting services of third party intermediaries to meet their transfer reporting requirements: The STA agrees that third parties may be utilized, as long as the third parties comply with the regulations. Again, the decision to utilize third parties should be up to the agent or broker and not mandated by regulation.

26: Whether the transferring person should communicate any information or justification to the transferee broker when no transfer reporting statement is required because the security is not a covered security: The STA believes that agents and brokers will want to pass information to each other, if available, even when no transfer reporting statement is required, as a customer service. This information may be supplied to shareholders as supplementary information, in addition to the required tax reporting. As part of the electronic transfer of data elements, we envision an indicator to designate pre and post effective date shares, and also one to indicate that no cost basis information is being passed because of the situation discussed in # 19, where the agents does not know if the transfer resulted from gifting, a death, or private sale. See discussion in #19.

27, 28, 29: No comment.

30: How to coordinate broker transfer reporting with issuer corporate action reporting to avoid duplicate broker adjustments when accounts are transferred and whether a universal timing standard should apply: This is a complicated issue, and the industry should discuss it further. Ultimately, it will be the business responsibility of brokers and agents to confirm within our industry that information is communicated

appropriately to facilitate accurate reporting. However, as a first step, the STA suggests that the 45 day notice period be shortened to 15.

31: To what extent a broker should verify the reasonableness of basis information and what document retention requirements should apply: Brokers and agents should not verify the reasonableness of basis information received from others, as they have no ability to do so. Agents will verify that the information gathered by their own systems is correct, as part of the normal quality and accuracy checks performed for all data. Regarding document retention, there is concern about the cost and burden of keeping large amounts of data available on systems. The STA recommends that documentation and files supporting acquisition, sale, or transfer records on transfer agency systems, be retained no longer than six years from the date of entry.

32: What procedures a broker should follow if the broker derives basis and holding period information for or from customers with respect to a security that is not a covered security, including potential reporting of such information to either the customer of the Service: The STA believes that basis reporting to the Service should be done on covered shares only. Agents and brokers may choose to provide basis information to customers on uncovered tax lots as a service, but it should not be part of tax reporting.

33: What procedures a transferee broker should follow if the broker does not receive a transfer reporting statement: The STA understands that there is an obligation to ensure that all necessary information received by the transferee broker is recorded and posted accurately, so that tax reporting will be correct. However, we do not believe that the transferee broker has any further obligation if the basis information is not received. The obligation to provide the information rests with the transferring broker.

34: What procedures a transferee broker should follow if the broker receives transfer reporting information with respect to a security that is not a covered security, or from a transferor who is not subject to the transfer reporting requirements: In discussions with members of SIFMA, we believe that STA agents will often times receive basis information for non covered shares. We are envisioning an indicator as part of the electronic file transfer that would identify the shares as uncovered and the reason. However, as stated above, we do not believe this information should be included in tax reporting. Additionally, as stated in our response to questions 1 and 2 above, the STA believes that “any entity that holds securities on its books and records should be subject to the regulation and be required to maintain basis and pass it to others as necessary. This would include even transfer agents that do not normally have tax reporting obligations.” This concept is essential for the regulation to work as anticipated.

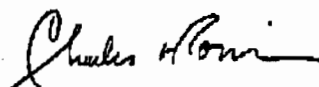
35: No comment

36: Under what circumstances penalties may apply to brokers or other reporting entities and when relief from penalties should be available. Brokers and agents are

aware that there are financial penalties for non-compliance with the basis reporting regulation; however, the entity that produces the 1099B does not completely control its own ability to produce a complete and accurate tax form, as the basis of shares and purchase date must be received, in some cases, from another covered institution. Transfer agents/brokers in this circumstance need assurance from Treasury and the IRS that the penalty to the transferee will be waived if the transferring entity did not provide this information as required. We recommend that the penalty abatement process have provision to allow an agent to state that basis was not provided when shares were moved to the agent, if that is the case, and that all penalties assessed because of this circumstance be waived. We also note that there will be times when shares may transfer between a record and payable date or during the process of a corporate action. In these circumstances the sending broker or agent will only be able to pass the basis of the shares as it resided on that broker's or agent's system. It will be the obligation of the receiving broker to complete the necessary basis adjustment. In these circumstances, the sending agent should not be assessed a penalty if the receiving broker fails to adjust the basis of the shares as is required. We believe that adding fields to indicate if a basis adjustment has been processed and if so, the date (see response to question 21) would help all parties be compliant. And finally, due to the complexity of building the electronic systems to pass basis information between agents and brokers, the inconsistencies between existing systems, and the complexity of retrofitting these existing systems to ensure full compliance, we recommend that no penalties be assessed for 5 years post implementation.

In conclusion, the STA supports the intent of the basis reporting regulation, believing it to be of great benefit to shareholders as well as to the Service. However, we hope that the final detailed regulations will facilitate workability for our members and for all covered institutions. In our meeting with representatives from Treasury and the IRS on December 18, 2008, we suggested that an ongoing dialogue would be helpful and we have asked to have further meetings for this purpose. We respectfully request that a meeting be set for the near future to address our recommendations, answer any questions, and discuss any other issues that may arise. The STA hopes to be a valuable resource to you as the details are worked out.

Sincerely,



Charles V. Rossi
President
The Securities Transfer Association, Inc.