American Bankers Association
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Submitted Via Electronic Mail

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Pamela Lew
Office of the Associate Chief Counsel (Financial Institutions and Products)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20024

Re: Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options; Proposed Rulemaking; 76 Federal Register 72652 (November 25, 2011).

Dear Ms. Lew:

The American Bankers Association[1] (ABA) appreciates the opportunity to provide comments on Internal Revenue Service (IRS) proposed regulations for basis reporting of debt instruments and options (Proposed Rule). Pursuant to the Emergency Economic Stabilization Act of 2008, "brokers," as defined under the Internal Revenue Code (Code), that file IRS Form 1099-B are required to report additional information on these forms, such as the adjusted cost basis of customer "covered securities" sold and whether any resulting gain or loss is short or long term. In addition, applicable persons, including brokers, custodians, and issuers, must furnish a transfer statement that contains certain information about the debt instruments and options when transferring securities to a receiving broker. Under the Proposed Rule, the reporting requirements will take effect for debt instruments and options acquired or granted after December 31, 2012.

In 2010, over 1200 banks held over 24 million fiduciary, custody, and safekeeping accounts valued at more than $87 trillion.[2] In providing these accounts, banks often fall within the definition of "broker" and are required to comply with the cost basis reporting requirements in Form 1099-B. Our members agree with the purpose and intent of the reporting requirements, but ask that certain measures be taken to accommodate our reasonable concerns, which we describe further below. In addition, as we mentioned in our February 12, 2010, and March 3, 2009, letters, we respectfully request that the IRS provide an exemption from cost basis reporting for corporate trustees of registered bonds.

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.
[2] FDIC Quarterly Banking Profile, 2011, Volume 5, N. 1, Table VIII-A. As used in this letter, the term "bank" includes banks, savings and loan associations, and trust companies that act in fiduciary and related capacities.

Compliance Date for Reporting of Debt Instruments and Options

As Congress implicitly acknowledged when it staggered the compliance dates for different types of securities, cost basis of debt instruments and options is very difficult to track, adjust, and report. ABA therefore strongly urges the IRS to change the effective date of the Final Rule to no earlier than January 1, 2015, for debt instruments, and to no earlier than January 1, 2014, for options.

This change would provide much-needed time for banks and other brokers to purchase and integrate the necessary additions to existing internal reporting systems, especially during this period of significant and demanding new requirements in tax reporting. First, brokers are completing the extensive changes in systems and procedures in order to comply with the 2012 average cost election requirements. Second, if the Final Rule is not amended to exclude complicated debt instruments from the cost basis reporting, brokers will need to prepare for calculations of bond premium amortization, original issue discount, acquisition premium and market discount for securities such as variable rate debt instruments, convertible bonds and other complex debt instruments. These new calculations will require system changes that must be tested during a long period in order to assure that they operate reliably, as intended, and do not lead to unanticipated problems in other areas of the systems. Lastly, the reporting of sales for options is totally new for brokers. Systems need to be adjusted to consider the treatment of option premiums and the identification of straddles to be able to comply with certain requirements of the Proposed Rule.

The IRS has the clear authority under Code Section 6045(g)(3)(C)(iii) to determine a later "applicable date" for the reporting of debt instruments and options. ABA strongly urges the IRS to use this authority to give brokers adequate time to install and test the reporting and tracking systems. As the Government Accountability Office acknowledged, misreported debt instrument and option sales represented only a small share of the total misreported securities sales.[3] In other words, most of the misreported securities are equity securities, the adjusted cost basis of which brokers have been reporting since January 1, 2011. A delay for debt instruments and options that constitute only a minor share of all misreported securities sales is a reasonable and appropriate accommodation.

Amortization of Taxable Bonds Would be Difficult to Assume

For purposes of calculating the adjusted basis, the Proposed Rule requires brokers to make two assumptions: (1) the customer has elected to use the constant interest rate method under section 1276(b)(2) to determine the amount of accrued market discount; and (2) the customer has elected under section 171 to amortize bond premium on a taxable debt instrument. These assumptions, although well-intended, do not conform to what the vast majority of bank customers currently elect, may be costly to implement while providing no useful information to the IRS, and would only serve to confuse bank customers who have *not* elected to amortize taxable bonds. We therefore recommend that the Final Rule only require amortization of covered debt instruments if the customer has informed the broker that the election to amortize taxable bonds has been made.

Without changing this assumption, the Final Rule would create discrepancies between the broker tax statement provided to the customer and the required tax reporting by the customer.

[3] *See* GAO Report, Capital Gains Tax Gaps, 11 (June 2006).

Customers expect their broker to provide information highlighting the areas of possible discrepancies. Therefore, banks would need to implement further communication mechanisms with the customers about the cost basis reporting and enhance their internal reporting systems to allow a dual treatment of non-covered and covered debt instrument elections. Furthermore, many brokers are now using third-party vendors to help in the calculation of amortization, original issue discount, acquisition premium, and market discount. These vendors may need to change not only the way they are calculating these adjustments but also the information required from the brokers. These changes will take time and would require extensive testing before implementation.

As brokers, banks are not in the business of providing tax advice and therefore do not advise their customers on whether to amortize their taxable bonds. The customer should be responsible for making the decision to amortize, because the election would affect taxable bonds held at other brokers. In addition, as trustees or executors, banks in general have not elected to amortize taxable bonds, because of the consequence to the principal and income of the trust. While amortization may reduce the reportable taxable interest to the income beneficiary, it may also reduce the cost basis of the assets, thereby increasing the amount of future capital gain when the asset is sold or matures.

Lastly, if the broker were to assume that the customer has amortized, then under Section 171 of the Code, the taxpayer must amortize all taxable bonds in that account, including those that are not "covered securities." If the broker decides to amortize the non-covered bonds, systems will have to be modified to store the previously unamortized amount that would have been amortized had the amortization been in effect since the bonds were purchased. In effect, the Final Rule would require the broker to keep *two* books of records for clients that have not elected to choose amortization: one for the client and one for purposes of the 1099-B reporting and transfer statements. Such a requirement would be excessively costly to maintain and of no help to the customer who in the end has not elected to amortize.

Transfer Reporting Requirements

The Proposed Rule requires brokers to transfer extensive information to the receiving broker if a customer decides to move his or her account to a new financial institution. For debt instruments, the Proposed Rule requires certain "additional information" in the transfer statement, including: (i) a description of the payment terms; (ii) the issue price of the debt instrument; (iii) the issue date of the debt instrument; (iv) the adjusted issue price of the debt instrument as of the transfer date; (v) the customer's initial basis in the debt instrument; (vi) the yield used to compute any accrual of original issue discount, bond premium, and/or market discount; (vii) any market discount that has accrued as of the transfer date; and (viii) any bond premium that has been amortized as of the transfer date.[4]

With the exception of the customer's initial basis in the debt instrument (Item (v)), brokers do not need to receive this additional information from a transferring broker when an account is moved.[5] Pursuant to current industry practice, brokers obtain this information from third-party

[4] 26 CFR 1.6045A-1(b)(3).

[5] Of course, the transferring broker must also send the customer's acquisition date, the adjusted cost basis, and the CUSIP of the covered security.

vendors or from the issuer's prospectus, as needed. It would be both unnecessary and burdensome to require the transfer of this information when the receiving broker may in the end disregard it. Furthermore, it is not clear whether the license agreement between the broker and third-party vendor would allow the transfer of this information to outside parties, such as a receiving broker. We therefore recommend that the Final Rule only require as additional information the customer's initial basis in the debt instrument.

Reporting of Compensation-Related Options
The Proposed Rule considers adding a new box on the Form 1099-B to indicate whether the sold security was acquired after exercising a compensation-related option. Unfortunately, the addition of any new variable to this Form, no matter how small, would significantly increase the cost to a broker's internal systems. This additional expense is due to the fact that the new information must be marked to the *individual* cost lot level field of the security. In addition to the expense of requiring brokers to keep this information, it is not clear where the broker would obtain the information in the first place. In many cases, the employee who received the compensation-related option exercises the option with the employer and transfers the securities into an investment management or custodial account. In these cases, the broker would not receive a transfer statement from the employer and would thus need to rely on the customer to disclose voluntarily that information.

In the end, because the Proposed Rule does not require the broker to adjust the cost basis for securities acquired through an exercise of a compensation-related option, we urge the IRS to eliminate this requirement from the broker transfer statement and Form 1099-B. We note that the customer would disclose this information when he or she adjusts the cost basis of the security on Form 8949.

Exemptions for Other Complicated Debt Instruments
ABA and our members greatly appreciate the reporting exemption for debt instruments that are described in section 1276(a)(6) (debt instruments with principal subject to acceleration), because of the great difficulty with calculating the adjusted basis. There are numerous types of debt that are now available to investors – many of which would also require complicated calculations to adjust basis. Most banks do not have the internal systems to handle all of the variations available for investment and thus rely upon data from third-party vendors to calculate OID, market discount, and bond premium amortization. We believe therefore that the IRS should exempt other debt instruments that do not have a fixed maturity date or a fixed interest rate from the reporting requirement for the same reason the section 1276(a)(6) bonds are exempted. Such debt instruments include but are not limited to the following: (1) variable rate debt; (2) contingent payment debt; and (3) convertible bonds.

Exemption for Corporate Trustees of Registered Bonds
ABA strongly urges the IRS to provide an exemption in the Final Rule for corporate trustees with respect to registered bonds and notes – i.e., bonds and notes in physical rather than book-entry form. The cost of newly acquiring customer basis information and establishing wholly-new systems for compliance far outweighs any benefits to the IRS of the information captured on the diminishing numbers of Form 1099-B for registered bonds and notes.

As we have noted in our previous letters, corporate trustees serving as indenture trustee, registrar, paying agent, or in similar capacities are only required to provide Form 1099-B to bondholders when registered bonds and notes mature, are called, or are redeemed. In these capacities, the bank receives a list of holders from the issuer and maintains ownership records of the debt securities, sometimes making ongoing interest payments. When corporate trustees maintain registered holder records for debt securities, they do not receive information relating to pricing and basis data for these debt instruments (e.g., reference price, bond premium, market premium or discount, date of amortization or accretion). Rather, corporate trustees receive only the holder information needed to maintain the registered holder records (e.g., holder or nominee name, tax identification number, address of record, face amount of position held).

It would be an enormous undertaking for corporate trustees to begin receiving the relevant pricing and basis data from the buying/selling broker and create wholly new compliant systems to maintain cost basis adjustments for the broad range of debt instruments serviced by corporate trustees. Moreover, imposing this new requirement on corporate trustees would result in duplicative cost basis reporting, redundant with the reporting being undertaken by buying/selling brokers and likely to produce reporting that is at variance with broker reporting covering the same debt instruments.

Importantly, the number of registered bonds and notes is decreasing significantly. In fact, the trend in the entire securities industry is toward dematerialization and immobilization of securities. The vast majority of bonds and notes are held in book-entry form at the Depository Trust Corporation, and the decline in the issuance of registered bonds and notes is expected to continue into the foreseeable future. Thus, if given no relief, corporate trustees will have to make very expensive changes for at best marginal gains in information reporting.

For the above reasons ABA recommends that the IRS revise Reg. 1.6045-1(n)(2)(ii) as follows:

> 1.6045-1(n)(2)(ii) *Excluded debt instruments*. The following debt instruments are not deemed to be a covered security:
>
> > (A) A debt instrument subject to section 1272(a)(6) (certain interests in or mortgages held by a REMIC, certain other debt instruments with payments subject to acceleration, and pools of debt instruments the yield on which may be affected by prepayments).
> >
> > (B) A registered debt instrument (i) which satisfies the definition of a debt security in registered form set forth in Treasury Regulation 5f.103-1(c)(1); (ii) is issued pursuant to an indenture or similar governing document and is serviced by an entity acting in the capacity of indenture trustee, registrar, paying agent, or similar function that maintains the record of registered debt securities holders; (iii) the registered holder of which is not a U.S. clearing corporation and depository; and (iv) is not held in custody by a broker who, in the ordinary course of a trade or business, stands ready to effect sales in securities.

The language of this proposed exemption is based on the IRS's existing definition of registered bonds and is narrowly crafted to exempt only corporate trustees that maintain the record of registered debt securities holders. The exemption specifically excludes registered debt instruments for which Depository Trust Company is the registered holder.

The ABA Corporate Trust Committee is available to provide additional information concerning this proposed limited exemption for registered bonds. Please feel free to call or write Cris Naser (202-663-5332 or cnaser@aba.com) on this issue.

Conclusion

ABA appreciates this opportunity to offer comments on the proposed regulations. We urge the IRS to change the effective date for debt instruments to 2015 and for options to 2014, as well as modify the Final Rule as suggested to minimize burdens on banks and other brokers. We again request that the IRS exempt corporate trustees of registered bonds from the cost basis reporting requirements. Should you have any questions or comments with respect to the issues raised in this letter, please do not hesitate to call the undersigned at (202) 663-5053.

Sincerely,

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