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By Hand Delivery

Mr. Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (REG-101896-09)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20024

Re: Comments on Proposed Cost Basis Reporting Regulations

Dear Mr. Schaeffer:

We write on behalf of the members of the Association of Global Custodians (the "AGC") to comment on the proposed cost basis reporting regulations issued on December 16, 2009 (REG-101896-09) (the "Proposed Regulations"). We support the efforts of the Internal Revenue Service (the "IRS") and the Department of Treasury (the "Treasury") to develop clear, practical, and effective regulations implementing the cost basis provisions under Section 403 of Public Law 110-343, the Energy Improvement and Extension Act of 2008, 122 STAT 3854, and we commend the IRS and Treasury for actively soliciting industry input in formulating the Proposed Regulations. In this regard, we convey members' broad support for the detailed comments of the Securities Industry and Financial Markets Association ("SIFMA") as submitted on February 8, March 24, and June 11, 2010, and we offer the following supplemental commentary as you work toward final rules.

AGC members are concerned about several sections of the Proposed Regulations that impart what we view as overly-burdensome requirements, that provide insufficient time to deploy necessary systems upgrades, and that fail to appropriately balance the legislation's objectives with the continuing goal of sound tax administration that fosters tangible benefits.

For reasons detailed below, we urge the IRS and Treasury to accommodate the following requests:

I. **Institute** a one year delay of transfer statement reporting.
II. **Remove** securities lending transactions from the transfer statement requirements.
III. **Exclude** noncovered securities from transfer statement reporting.
IV. **Delay** the application of the basis, issuer and transfer reporting requirements on non-U.S. securities for one year.
V. **Implement** a one year cost basis reporting moratorium for brokers that effect transactions at an office outside the United States.

Institute a one year delay of transfer statement reporting

For reasons set out below, the AGC requests Treasury and the IRS to use the broad authority available under the statute and delay one year the effective date for transfer statement reporting. If this request is adopted, transfer reporting would apply only to transfers that occur on or after January 1, 2012. It would be of great assistance to custodians if the IRS and Treasury would provide immediate guidance to the industry reporting such a delay in effectiveness. AGC members believe this step would represent an appropriate use of the Secretary's powers to ensure that brokers and custodians have the necessary time to implement the cost basis reporting law fairly and efficiently.

Beginning January 1, 2011, section 6045A of the Internal Revenue Code (the "Code") requires any applicable person transferring the custody of a *covered security*[1] to issue a transfer statement to the receiving broker that includes information necessary for the receiving broker to properly report once the customer sells their position. Taken alone, the requirements set out in this new section of the Code are isolated to instances where the securities transferred are "covered" as defined in § 6045(g)(3). However, the Proposed Regulations greatly expand the transfer statement reporting requirements by requiring custodians and other applicable persons to issue transfer statements in any transfer of a *specified security*[2], as defined in Proposed Treasury Regulation Section

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[1] Generally, the statute defines a covered security as any *specified security* acquired on or after the applicable date. In the case of equities (other than stock of a Regulated Investment Company (RIC) or stock held under a Dividend Reinvestment Plan (DRP)), the applicable date is January 1, 2011. For RIC or DRP stock, the applicable date is January 1, 2012. For all other securities, the applicable date is January 1, 2013 unless postponed by the IRS.

[2] A specified security includes any share of stock in a corporation; any note, bond, or debenture, or other evidence of indebtedness; and any commodity or contract in such commodity as determined by the Treasury.

1.6045-1(a)(14)[3]. Consequently, any transfer of an equity security on or after January 1, 2011, irrespective of the date of acquisition, generates a transfer statement requirement. This also includes securities acquired by accountholders exempt from reporting under Section 6045 (*e.g.,* entities registered under the Investment Company Act of 1940) at the time of acquisition that are treated as "noncovered" under Proposed Treasury Regulation Section 1.6045A-1(b)(2). This expansion was unforeseen based on a reading of the statutory text and the corresponding legislative history[4], and it significantly increases the complexity and number of systems enhancements necessary to ensure compliance. Indeed, prior to the issuance of the Proposed Regulations, global custodians could not anticipate the ultimate breadth of the transfer statement reporting obligations, and as a result were not prepared to commence system development plans on the urgent track that would be required. The AGC agrees with SIFMA and other industry participants who have emphasized the need for 18-24 months to implement significant systems and process changes to accommodate something as extensive as cost basis reporting. Such a delay is particularly necessary in view of the expanded scope of the transfer statement reporting rules under the Proposed Regulations.

We emphasize that the industry faces a daunting – and likely impossible – task of implementing these rules in time for the January 1 effective date without incurring significant confusion, cost, and ultimately, inaccurate reporting. Exacerbating the situation, brokers and custodians typically halt ongoing systems development in December primarily to avoid impacting end-of-year processing. Given that practice, the industry will in effect have less than 12 months from the Proposed Regulations' issuance date (and less than 6 months from the date of Final Regulations) to make the necessary systems changes without negatively affecting existing systems and processes. Making the task even more challenging, the transfer statement reporting requirements entail novel processing steps. While the other cost basis requirements applicable to Form 1099-B are demanding in their own right, they at least modify an existing tax information reporting process with which custodians are sufficiently familiar. Such familiarity naturally improves a custodian's ability to execute systems changes timely and effectively.

Remove securities lending transactions from the transfer statement requirements

Under Proposed Treasury Regulation § 1.6045A-1(b)(5), if a security is borrowed from or through an applicable person, a transfer statement must be issued indicating the securities are borrowed and reporting the adjusted basis equal to zero. For the

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[3] The Proposed Regulations also redefine the term "specified security" for purposes of the regulations to include only equity securities (other than RIC or DRP stock) in 2011.

[4] See, *e.g.*, the discussion in the Joint Committee Summary of P.L. 110-343.

following reasons, the AGC urges the IRS and Treasury to eliminate this requirement in the final regulations:

- ***Statements are Unnecessary***: As stated in the Preamble to the Proposed Regulations, the primary purpose of this requirement is to alert a receiving broker that the securities received are borrowed in case the transfer's purpose is to satisfy a short sale obligation. This alert is intended to assist the broker to report the short sale of Form 1099-B at the proper time, as the short remains open under Section 1233 of the Code. While the AGC generally supports regulations that assist brokers and custodians in meeting their tax reporting obligations, we believe this requirement under the Proposed Regulations is superfluous and redundant.

  First, any broker effecting short sales for their customers will be fully involved in facilitating the necessary transfers and will thus be aware that the securities received to cover an open short sale are in fact borrowed. The basic premise underlying the policy of issuing transfer statements in securities lending transactions is therefore not met by market reality.

  Furthermore, the requirements of §1.6045A-1(b)(5) fail to recognize that the large majority of securities lending transactions occur with custodians acting as agent for institutional investors (of which the large majority are exempt recipients for purposes of Form 1099-B reporting) without any knowledge of whether the securities are actually borrowed to facilitate a short sale or for another purpose. Thus, in many cases, the Proposed Regulations would create an extraordinary number of transfer statements that will ultimately serve no purpose.

- ***No Effect on Form 1099-B Reporting***: Under Section 1058 of the Code, dispositions of securities associated with lending and borrowing of securities are nontaxable events provided the terms of § 1058 are satisfied. Therefore, no Form 1099-B reporting is generated as a result of these transactions. Additionally, for tax purposes, the basis of the securities as well as the applicable holding period in the hands of the lender is unchanged in the case of a Section 1058 transaction, and thus any information conveyed on a transfer statement in these types of transactions will provide no tangible value in furthering the goal of Congress to improve Form 1099-B compliance.

- ***Lack of Guidance on Returns of Borrowed Securities***: While the Proposed Regulations prescribe transfer statement reporting obligations for securities borrowed from or through an applicable person, they fail to contemplate transfers associated with the return of borrowed securities (*i.e.*, when the borrower returns the securities to the lender at the end of the loan's

term). This lack of clarity has resulted in extensive confusion about the information that must be included on such transfers, how lenders and their agents should react to inconsistencies between information included on the outbound transfer (from the lender to the borrower) and the information contained on the return transfer statement, and, indeed, whether such transfers are even in scope. Accordingly, in addition to accommodating our request above that the IRS and Treasury remove securities lending transactions from the transfer statement requirements, we urge the IRS and Treasury to clarify that transfers associated with returns of borrowed securities are not within the scope of the transfer statement requirement.

Exclude noncovered securities from transfer statement reporting

The AGC joins SIFMA in respectfully urging the IRS and Treasury to rewrite the final regulations under Section 6045A to more closely adhere to the original language set out in the statute by requiring transfer statements only in circumstances where the transfer involves covered securities.

As discussed above, the transfer statement requirements prescribed by the Proposed Regulations present serious challenges to custodians, and ultimately divert limited resources away from more critical issues and efforts that would advance the overall goal of the legislation. To assist custodians in focusing on those critical matters, we urge the IRS and Treasury to permanently exclude noncovered securities from the transfer statement reporting requirements. Although the AGC appreciates the concerns expressed by IRS and Treasury representatives in establishing the default rule that requires transfer statements in all transfers of specified – rather than covered – securities, we believe that any benefit derived from such a broad rule is outweighed by its very great costs.

For example, because of the broad requirement to issue transfer statements for all securities held by exempt recipients (*i.e.,* treated as "noncovered"), custodians will have to issue transfer statements when transferring the securities of non-U.S. beneficial accountholders (including foreign government organizations), as well as for securities held by U.S. exempt entities such as Regulated Investment Companies (RIC) and Real Estate Investment Trusts (REIT). In fact, the large majority of transfers effected by custodians are on behalf of these types of institutional investors, which are generally exempt from reporting under Section 6045 of the Code. Transfer statements for these categories of investors will provide no pertinent information to the receiving custodian and will generate wasteful reporting and unnecessary work for financial institutions.

Delay the application of the basis, issuer and transfer reporting requirements on non-U.S. securities for one year

The AGC believes the postponement of basis reporting on non-U.S. securities will not seriously compromise the broad intent of the legislation or the responsibilities assigned to the Treasury and IRS under the statute. For the following reasons we request that non-U.S. securities be exempted from the basis reporting, issuer and transfer reporting requirements in 2011.

The AGC appreciates the need to ensure that U.S. taxpayers are properly reflecting capital gain and loss on their tax returns, even in the case of non-U.S. securities held at financial institutions in the United States and in local markets around the world. While the AGC recognizes that Form 1099-B reporting generated from these transactions is an important component to overall taxpayer compliance, there are several factors that make the proposed reporting requirements associated with these securities cumbersome at best and unattainable at worst.

First, many foreign issuers of equity securities do not and are not presently required by any law to furnish information to investors or to the street on the U.S. tax consequences of corporate actions with respect to foreign equities. Generally, such equities are excepted from requirements to file a prospectus, proxies or other financial reports with the U.S. Securities and Exchange Commission (SEC) that would otherwise include tax disclosure on corporate events. It will no doubt take time to establish international standards for U.S. tax disclosure and to educate the affected foreign issuers of their U.S. tax reporting obligations.

Second, in transfers of U.S. securities held domestically, financial institutions have an existing infrastructure through the Cost Basis Reporting System ("CBRS") at the Depository Trust and Clearing Corporation ("DTCC") they can use to meet the transfer statement reporting requirements. In transfers of securities held outside the U.S., no similar established centralized facility exists. The complexity of recording, adjusting, and reporting amounts that settle in non-local currency is magnified by this lack of established infrastructure. Moreover, certain AGC members have experienced resistance from their non-U.S. counterparties in facilitating and accepting transfer statements from U.S. custodians. In these circumstances, it appears a transfer statement would need to be sent "in writing" (according to Proposed Treas. Reg. § 1.6045A-1(a)(2)), despite the objections of the recipient custodian.[5] This scenario endangers the confidentiality of information that may be contained within a transfer

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[5] For example, it appears an electronic default delivery method, such as a message published via the SWIFT (Society for Worldwide Interbank Financial Telecommunication) infrastructure, does not satisfy the "in writing" requirement because this requires consent on behalf of the recipient. See § 6045A, Prop. Treas. Reg. § 1.6045A-1(a)(2), and Section 401 of the Job Creation and Worker Assistance Act of 2002, P.L. 107-147, 116 Stat. 40 (2002).

statement, such as the customer's taxpayer identification number (TIN), and simply put, creates the untenable requirement that U.S. custodians must disseminate written statements containing confidential information to non-U.S. entities that have no interest in accepting them. The best course is to phase-in the reporting requirements for non-U.S. equities (including American Depository Receipts) until a later year when common standards of U.S. tax disclosure and an infrastructure for offshore transfers of securities can be established.

Implement a one year cost basis reporting moratorium for brokers that effect transactions at an office outside the United States

Citing the issues around obtaining accurate cost basis information for non-U.S. securities, and the general complexity in developing the necessary systems enhancements, the AGC requests the IRS and Treasury delay the effective date for including cost basis information in Forms 1099-B that are filed by brokers that effect transactions at an office outside the United States, including non-U.S. branches of U.S. brokers and non-U.S. brokers treated as Controlled Foreign Corporations (CFC) under § 957(a) of the Code. These brokers are likely to be less prepared for basis reporting when compared to their counterparts located in the United States. This is primarily because they typically have relatively small populations of account holders who are either actual or presumed U.S. non-exempt recipients, given the institutional orientation of the custody business. As a result, they have previously had little or no need to build or acquire a robust gain/loss reporting system for securities. So, brokers who are doing business overseas likely will have significantly more to do in a much shorter period of time to become ready for basis reporting. They are further handicapped because of the present lack of final Treasury regulations, the potential for a changing set of reporting requirements, and less detailed familiarity with U.S. taxation of securities. In short, members believe that brokers doing business overseas should be excused from basis and transfer reporting at least until 2012.

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The AGC greatly appreciates the opportunity to provide the IRS and Treasury with members' comments, and we hope the foregoing information and perspective will

aid the effort to finalize these important regulations. If you have questions concerning the foregoing or would like additional information, please contact the undersigned at 312.861.2620 as an initial matter.

Sincerely yours,

Dan W. Schneider
Baker & McKenzie LLP
Counsel to the Association