INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Andrea Taylor
Director

March 13, 2012

CC:PA:LPD:PR (RED-102988-11)
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington DC 20044

SENT VIA EMAIL

Re: REG 102988-11 Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options (the Proposed Regulations)

Dear Sirs/Mesdames:

The Investment Industry Association of Canada (**IIAC**)[1] appreciates the opportunity to provide comments on the Proposed Regulations, which would further implement requirements under Sections 6045 and 6045A of the Internal Revenue Code (the **Code**). This submission will focus on the complex challenges that basis reporting currently creates for reporting by Canadian Qualified Intermediaries (**QIs**), most of whom are not U.S. payors. The Proposed Regulations will further complicate these challenges by implementing basis reporting requirements for debt instruments and options as of January 1, 2013.

IIAC has previously provided extensive comments on both the proposed changes to the Code, and the final Regulations published October 18, 2010, entitled "Basis Reporting by Securities Brokers and Basis Determination for Stock" (the **Regulations**). We also submitted a letter (dated May 4, 2011) to the Department of the Treasury (**Treasury**) and the Internal Revenue Service (**IRS**) to seek clarification regarding the interaction between the Regulations and the guidance provided in IRS Notice 2011-34 that foreign financial

[1] IIAC is Canada's equivalent to the Securities Industry and Financial Markets Association (**SIFMA**) in the United States, and represents over 180 investment broker-dealers across Canada. The IIAC U.S. Tax Committee is responsible for reviewing and commenting on amendments to legislation that would affect the Canadian QI community, and developing positions on practical and conceptual matters surrounding U.S. tax reporting requirements, including audits and QI forms.

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-687-5476 Fax: 416-364-4861 ataylor@iiac.ca http:// www.iiac.ca

institutions (**FFIs**) that are non-U.S. payors are to be excluded from the cost basis reporting requirements. We have not yet received the clarification requested in that letter, and reiterate our request in this letter.

Our requests – a summary

1. **The Canadian QI community would welcome an immediate and clear statement, either in future guidance or regulations, from Treasury and the IRS that will ultimately completely exempt QIs that are non-U.S. payors from the cost basis reporting requirements under both the previously finalized Regulations and the Proposed Regulations.**

2. **At a minimum, we request that Treasury and the IRS exercise the authority granted under Section 6045 to postpone the implementation of basis reporting for debt instruments and options to no earlier than January 1, 2015.**

Background

As mentioned previously, most Canadian QIs are non-U.S. payors. For a non-U.S. payor, proceeds from the disposition of U.S. securities are reportable payments if sales are effected in the U.S. within the meaning of Treas. Reg. section 1.6045-1(a), and proceeds from the disposition of non-U.S. securities are reportable payments if payment is made in the U.S. within the meaning of Treas. Reg. section 1.6049-5(e). On this basis, Form 1099-B reporting of proceeds of disposition by a QI that is a non-U.S. payor is generally only required for U.S. non-exempt recipients residing in the U.S., with some exceptions.

Notably, Treas. Reg. §1.6045-1(g)(iii)(B)(3) sets out the rules for when a sale is considered to be effected at an office inside the U.S. These conditions include situations where:

1. the customer has opened an account with a U.S. office of the broker,
2. the customer has transmitted instructions concerning sales to the foreign office of the broker from within the U.S. by mail, telephone, electronic transmission or otherwise (unless the transmissions from the U.S. have taken place in isolated and infrequent circumstances),
3. the gross proceeds of the sale are paid to the customer by a transfer of funds into an account (other than an international account as defined in §1.6049-5(E)(4)) maintained by the customer in the U.S. or mailed to the customer at an address in the U.S.,
4. the confirmation of the sale is mailed to a customer at an address in the U.S., or
5. an office of the same broker within the U.S. negotiates the sale with the customer or receives instructions with respect to the sale from the customer.

The Canadian QI community has a number of account holders for whom payment will be considered to be effected at an office inside the U.S. primarily because of conditions #2

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-687-5476 Fax: 416-364-4861 ataylor@iiac.ca http:// www.iiac.ca

and/or #4 above. The Regulations will require cost basis reporting for these types of account holders.

Excessive costs associated with compliance relative to potential additional tax revenue

As a result of various securities regulations and other compliance requirements, most QIs have a very limited number of accounts for U.S. non-exempt recipients residing in the U.S. Given the proximity of Canada to the U.S. and the mobility of individuals back and forth across the border, the Canadian QI community likely has a greater number of account holders for which the reporting of proceeds on Forms 1099-B is required than do QIs in other jurisdictions. Nevertheless, initial estimates by Canada's largest brokers indicated that less than 1% of their total accounts require Form 1099-B reporting of proceeds. Furthermore, the aggregate amount reported on Forms 1099-B by QIs is likely negligible in relation to the amount reported by U.S. paying agents. A review of Forms 1099-B actually submitted to the IRS would probably confirm this assumption.

We can also confirm that the comments made previously by IIAC to Treasury and the IRS prior to the implementation of cost basis reporting have become a reality: The U.S. tax rules associated with the calculation, maintenance and reporting of basis information have been extremely complicated and costly for brokers in Canada, largely requiring significant levels of manual record keeping because of the small number of accounts affected.

Further implementation of the Proposed Regulations by QIs in Canada will significantly compound the problem and costs associated with complying, given the increased complexity in determining cost basis reporting for debt instruments and options – we believe that these are costs that likely will not result in significant increases in tax revenue.

Extreme burden faced by FIs already preparing for FATCA

Back in 2010, IIAC asked Treasury and the IRS to be mindful of the additional reporting burdens that would be placed upon FFIs (including QIs) under the Foreign Account Tax Compliance Act (**FATCA**). We still believe that FFIs and QIs must justify the use of scarce resources in a difficult economy to accommodate the reporting needs associated with a relatively small percentage of the overall client base.

Again, we can confirm that the combination of FATCA requirements and the cost basis reporting requirements have severely strained the resources of Canadian FIs and may still force many QIs to consider whether or not it is economically feasible to service their U.S. clients. This is compounded by the fact that the implementation of both FATCA and the Proposed Regulations begin in 2013.

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-687-5476 Fax: 416-364-4861 ataylor@iiac.ca http:// www.iiac.ca

We have noted in previous submissions that the following comments were made in the Regulations recognizing that there should be coordination between the basis reporting requirements for non-U.S. payors and the reporting requirements under FATCA.

> *"The Treasury Department and the IRS intend to issue future guidance coordinating the reporting requirements under section 6045 with the reporting requirements under section 1471."*

Accordingly, it is our view that Treasury and the IRS left open the possibility of completely eliminating any cost basis reporting requirements once they considered the reporting requirements they would promulgate pursuant to section 1471.

We also note Section IV.C of IRS Notice 2011-34 which stated:

> *"Treasury and the IRS intend to issue guidance providing that FFIs that are not U.S. payors (as defined in §1.6049-5(c)(5)) and that report the information required under section 1471(c)(1)(D) with respect to a U.S. account will not be required to report tax basis information required under section 6045(g) with respect to the account."*

This section seems to indicate that an FFI that is a non-U.S. payor and that enters into an FFI Agreement with the IRS and performs the required reporting under the FFI Agreement will not be required to perform cost basis reporting. Many of our members have considered whether this portion of the Notice means that FFIs that are non-U.S. payors that enter into an FFI Agreement with the IRS will not be required to report cost basis information. Since all QIs will be required to enter into an FFI Agreement, it appears that QIs that are non-U.S. payors and that perform the required reporting should be exempt from cost basis reporting. As mentioned previously, IIAC sought clarification on this interpretation from Treasury and the IRS by way of a statement in future guidance or regulation – but to date this has not been addressed.

Our concerns

While Notice 2011-34 appears to provide for a complete exemption, Canadian QIs are concerned that it is only a statement of intent, and that ultimately, the scope of the exemption may be more narrow than that necessary to provide for a complete exemption from cost basis reporting. When the Regulations were released, a general statement was made that non-U.S. payor QIs were exempt from cost basis reporting. However, a closer reading of the Regulations revealed a narrow exception to this rule that resulted in Canadian QIs being unable to make use of the exemption.

Since Notice 2011-34 did not explicitly state an intention by Treasury to overrule the Regulations, our Canadian FFIs and QIs are concerned that the possibility of a Participating FFI effecting sales in the U.S. was not contemplated. The concern is that the statement in Notice 2011-34 regarding a forthcoming cost basis reporting exclusion was merely intended to advise FFIs that no new cost basis reporting requirements would be created by the 1471

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-687-5476 Fax: 416-364-4861 ataylor@iiac.ca http:// www.iiac.ca

regulations. Accordingly, our members are concerned that future 1471 regulations may be drafted in such a way that Canadian QIs would still need to comply with the Regulations and perform cost basis reporting when a sale is effected in the U.S.

Our recommendations

Although the number of account holders of Canadian QIs for whom basis reporting would be required under these rules will be significantly less than 1% of the total number of accounts that are subject to the QI Agreement, it has proven sufficiently high enough to make a manual process extremely burdensome – and this manual process will have to be expanded to include the requirements under the Proposed Regulations for debt securities and options.

Canadian QIs are generally of the view that the uncertainty regarding the scope of the possible exemption described in Notice 2011-34 leaves them no option but to continue to devote resources and funding to implement changes that may ultimately prove to be unnecessary.

Accordingly, the Canadian QI community would welcome an immediate and clear statement, either in future guidance or regulations, from Treasury and the IRS that will ultimately completely exempt QIs that are non-U.S. payors from the cost basis reporting requirements under both the previously finalized Regulations and the Proposed Regulations.

At a minimum, we request that Treasury and the IRS exercise the authority granted under Section 6045 to postpone the implementation of basis reporting for debt instruments and options to no <u>earlier than January 1, 2015</u>.

We would greatly appreciate the opportunity to discuss this in more detail as soon as possible. Please contact me directly if you would like to arrange such a discussion, or if you have any questions.

Sincerely,

"Andrea Taylor"

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-687-5476 Fax: 416-364-4861 ataylor@iiac.ca http:// www.iiac.ca