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

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Mr. Russ Sullivan
Democratic Staff Director
Mr. Kolan L. Davis
Republican Staff Director
Mr. Mark Prater
Republican Chief Tax Counsel
Senate Committee on Finance
Mr. Edward Kleinbard
Chief of Staff, Joint Committee on Taxation
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Mr. John L. Buckley
Majority Chief Tax Counsel
Mr. Jon Traub
Minority Chief Tax Counsel
House Committee on Ways and Means
1110 Longworth House Office Building
Washington, D.C. 20515

Dear Sirs:

Re: IIAC Comments on Basis Reporting Proposals under Internal Revenue Code S. 6045

The Investment Industry Association of Canada (IIAC) would like to comment, on behalf of the Canadian Qualified Intermediary (QI) community, on the basis reporting proposals under section 6045 of the Internal Revenue Code as currently contained in the *Administration's Fiscal Year 2009 Revenue Proposals* and tax title of H.R. 6, *the Clean Renewal Energy and Conservation Act of 2007*, and also as evidenced in H.R. 3996, *Temporary Tax Relief Act of 2007*. The proposals would require reporting of a client's adjusted cost basis in a covered security – stocks; notes, bonds, debentures or other evidence of indebtedness; any commodity, contract or derivative with respect to the commodity; and any other financial instrument for which the Secretary determines that basis reporting is required – as well as identification of whether a gain or loss with respect to the security is long- or short-term. These requirements are scheduled to apply to stocks (including investments in regulated investment companies or RICs) acquired or transferred on or after Jan. 1, 2009, and to all other securities on or after Jan. 1, 2011.

Our members not only share the concerns expressed by U.S. organizations in regard to these proposals, but also have serious additional concerns more particular to QIs and other foreign intermediaries. We urgently request that the proposed legislation be amended to exclude QIs and other foreign intermediaries altogether or as a minimum that Treasury be given broad regulatory authority to carve them out or set rules recognizing the particular difficulties they face.

Treasury Secretary Paulson said that his goal "… is to promote the conditions for American prosperity and economic growth – and maintaining the competitiveness of [U.S.] capital markets is central to that goal." Capital markets and tax systems are connected. We believe that implementing tax provisions that will force foreign intermediaries to incur significant costs for a very small client base risks adding to current challenges to the pre-eminence of American capital markets. We therefore request that the proposed legislation be amended and that rules applicable to foreign intermediaries be addressed separately for the reasons outlined below.

General Recommendations

1. **Provide for Regulatory Authority to Exclude QIs.** We fully support the recommendation made by the Securities Industry and Financial Markets Association (SIFMA) in its June 28, 2007 letter to Russ Sullivan and Kolan Davis, specifically that Treasury should be given broad regulatory authority to implement the new requirements and, in particular, to provide for limited exceptions if justified. ***Treasury should have the authority to exclude QIs (and other foreign intermediaries) from being subject to the rules as proposed and to deal with them separately from U.S. brokers due to the different challenges they face.***

2. **Consult with QIs Due to Additional Challenges Faced by QIs.** In addition to the concerns and complications with the proposals that have been raised by U.S. brokers – all of which apply equally to QIs – there a number of additional challenges, which the proposals present for QIs that are less likely to impact U.S. brokers. Some of these challenges, listed in Appendix A, add cost and complexity for QIs, while the amount of additional tax revenue that is likely to be collected as a result of requiring QIs to report basis information is limited, as discussed further below in Background Information Regarding QIs. We would appreciate the opportunity to work with the Treasury Department and IRS to ensure that the potential tax revenue gains and costs associated with providing the information are assessed, and that all reasonable alternatives are fully considered. ***Before any legislation requiring basis reporting by QIs is introduced, we believe that there should be consultation with the QI community. We would welcome the opportunity to work with the Treasury Department and IRS to ensure that interests of all parties are taken into account and that a reasonable solution is developed.***

3. **Defer Effective Date**. We agree with SIFMA's recommendation that the effective date of any new reporting requirements should be based on finalization of Treasury regulations. As noted in SIFMA's submission, "Brokers cannot develop or modify their basis reporting systems if they do not know the rules they must follow." Moreover, given the complexity of basis reporting and depending on the nature of any requirements that might be implemented, 18 months may not be sufficient. ***We recommend that the effective date of any new reporting requirements applicable to QIs be based on finalization of Treasury regulations and that a reasonable effective date, including a phased implementation, be determined through consultation with QIs.***

4. **Recognize Taxpayer Responsibility.** Although we acknowledge that it would be efficient to have brokers report basis information related to dispositions by U.S. non-exempt recipients as a means of verifying gains and losses reported by taxpayers, the efficiency will be lost if the cost to brokers is excessive and, despite the brokers' best efforts, calculations are inaccurate. Taxpayers have an obligation to retain the information supplied by their broker that supports their cost calculations. It seems particularly unfair to shift this burden to a foreign financial institution to which data is not available. If a U.S. person residing in the U.S. makes a decision to use the services of a foreign financial institution, it should be recognized that the foreign financial institution may not be able to provide all information in the format that a U.S. taxpayer requires and that the taxpayer therefore may have to assume greater responsibility and cost with respect to recordkeeping**.** ***We strongly recommend that foreign financial institutions be excluded from basis reporting obligations.***

Background Information Regarding QIs

The majority of Canadian QIs are non-U.S. payors, and have assumed non-resident alien (NRA) withholding and backup withholding and 1099 reporting responsibilities. Section 8.04 of the QI Agreement sets out the Form 1099 reporting responsibilities of a QI. With respect to QIs that have assumed backup withholding and 1099 reporting responsibilities (i.e., "withholding QIs"), Form 1099-B reporting of proceeds is addressed in section 8.04(d) of the

Agreement, which requires the QI to file Form 1099 for a "reportable payment" other than a "reportable amount". These reporting obligations also apply to a QI that has not assumed backup withholding and Form 1099 reporting responsibilities (i.e., a "non-withholding QI") unless, under the procedures of section 3.05 of the Agreement, another payor has agreed to undertake the reporting and backup withholding as required and the QI does not know that the other payor has failed to withhold or report. Section 2.44 of the QI Agreement defines "reportable payment" in the case of a non-U.S. payor.

Although there are exceptions, in very general terms, the obligations of a non-U.S. payor QI to report proceeds are generally limited to the sale of securities by U.S. non-exempt recipient accountholders residing in the U.S. and either:

1. in the case of U.S. securities, regularly transmitting instructions from within the U.S. to the QI or
2. in the case of non-U.S. securities,
    - regularly transmitting instructions from within the U.S. to the QI or
    - receiving confirmation of the sale by mail to an address 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 is likely to have a greater number of accountholders for whom the reporting of proceeds on Forms 1099-B is required than do QIs in other jurisdictions. Nevertheless, initial analysis indicates that even Canadian QIs do not have a significant number of such accountholders. Two of the largest Canadian brokers found, based on initial estimates, that the number of accountholders for whom reporting of proceeds was required was less than one per cent of their total number of accounts subject to their QI Agreements.

Given the small number of accountholders for whom basis reporting will likely be required, it is unlikely that QIs will be able to cost-justify making the complex and costly systems changes that would be required to fully automate the calculation and maintenance of cost-basis information for purposes of satisfying the proposed reporting requirements. As a result, alternative solutions that require greater reliance on manual procedures will likely be required, still with a significant cost to the QIs that will almost certainly have no ability to recover related costs from the client.

The brief summary of some of the challenges faced by QIs if they are required to provide basis reporting to those accountholders receiving Forms 1099-B reporting proceeds of disposition is provided in Appendix A to this letter. We would very much appreciate the opportunity to meet with Treasury Department and IRS staff directly to provide additional details supporting the need to exclude QIs and other foreign intermediaries from the basis reporting requirements as they are currently drafted, and to discuss alternatives.

Yours truly,

The **Investment Industry Association of Canada** (IIAC) is a member-based, professional association that advances the growth and development of the Canadian investment industry. IIAC acts as a strong, proactive voice to represent the interests of the investment industry for all market participants. Our 200 member firms range in size from small regional brokers to large investment dealers that employ thousands of individuals across the country. Our members work with Canadians to help build prosperity and financial security for investors and their families.

APPENDIX A

SUMMARY OF SOME CHALLENGES RELATED TO BASIS REPORTING BY QIS

No or Limited Basis Calculations Currently Performed. Many QIs do not currently have systems that maintain basis information or they provide such information as a client service only, qualifying the accuracy of the information being provided. The reliability of the information is frequently limited by a number of factors, including the accuracy of information that is provided by previous brokers for assets transferred to the client's account. Significant enhancements to systems and procedural changes would be required to refine the accuracy of the information provided. Given the estimated number of clients for whom such reporting would be required – two large firms estimate that the proposals would apply to less than one per cent of their client base, the QI may need to rely on manual processes and procedures.

Multiple Basis Calculation Methods. Canadian QIs that are providing basis information calculate cost using the *weighted average cost method* as required for Canadian income tax purposes (other calculation methods may be used by QIs in other jurisdictions). For this reason, Canadian QIs would need to maintain at least two types of tracking systems. In addition to the calculation of cost being different for Canadian and U.S. reporting purposes, the U.S. calculations are further complicated by rules that apply different methods to different types of assets, and also allow individual taxpayers to elect to use different methods. The requirement to separately report short- and long-term capital gains (based on U.S. tax requirements) would add an additional element of cost and complexity.

Foreign Exchange. The calculations are further complicated for foreign exchange translation reasons. For many accountholders with accounts outside the U.S., the base currency of the account will not be U.S. dollars. Additional information will need to be maintained if cost must be determined in U.S. dollars based on the exchange rate in effect at the time of the transaction, which could vary between parties based on the source of their rate information.

Determination of U.S. Tax Implications of Corporate Actions. Corporate actions are currently processed in accordance with tax laws or standard industry practices applicable in the QI's jurisdiction. There will be a significant cost associated with determining the U.S. tax implications of the event on the cost of a U.S. taxpayer's holdings, as well as posting the event differently for U.S. tax purposes. This is further complicated by the fact that a large portion of the securities held by QIs are non-U.S. and information regarding the U.S. implications of an event may not be readily available.

Basis Calculations Impacted by Non-Cash Amounts. The cost of certain types of investments is not necessarily based on cash payments. For example, the cost of a partnership interest is based on the investor's share of the partnership's income or loss, as well as contributions to and withdrawals from the partnership. For other investments, distributions may automatically be reinvested without the issuance of cash. Custodians do not readily have the information required to maintain tax cost information in these situations.

Existing Accountholders that Become U.S. Persons. Given initial findings that suggest that basis reporting might be required for less than one per cent of a QI's client base, it is unlikely that the calculation process and data retention can be automated. On that basis, it would only be practical for a QI to maintain such information for those clients to whom the reporting is required. This creates potential problems in the case of clients that become U.S. persons at a later date, unless cost at the time of becoming a U.S. person can be used in all such situations.

Filing Deadline. Although the proposed legislation extends the Form 1099 filing deadline from January 31 to February 15, the timelines remain very tight for QIs. This is particularly true:

- where there has been a corporate action for which the issuer is required to furnish additional information
- where there has been a transfer of securities late in the year for which the transferor must furnish basis information by January 15 following year-end
- for holdings such as certain Canadian mutual funds, for which a portion of distributions may be a return of capital, impacting cost basis, but for which the information is not often available prior to February 15 or later
- for reinvestment amounts for the many investments with automatic dividend reinvestment plans for which the amounts are often not identified until after year-end.

Transfer of Basis Information between Brokers. Based on earlier discussions related to the small percentage of accountholders for whom reporting would be required, if QIs are dependent on manual procedures to calculate, track and report U.S. cost, it will be difficult to develop standard methods for efficiently transferring cost information when shares are transferred from one QI to another. While we agree with SIFMA's concerns regarding a delay of up to 45 days for the transfer of this information, in other respects this may not be long enough to allow the transferring broker to complete the calculations.

Reconciling Differences with Accountholders. Despite best efforts on the part of the QI to provide accurate basis information, it is inevitable that there will be differences between the amounts determined by the QI and its accountholders. Considerable resources will be consumed addressing these differences with accountholders, and most likely at a time when these resources are otherwise engaged in year-end reporting activities. In addition to the demand on resources, despite all efforts by the QI, these differences are often likely to result in friction and client dissatisfaction with no easy solution.

Procedures under Section 3.05 of the QI Agreement. Under Section 3.05 of the QI Agreement, a QI that has not assumed backup withholding and Form 1099 reporting responsibilities can request another payor to report and, if required, backup-withhold on broker proceeds. Other payors that have agreed to take on this reporting and withholding responsibility may not have the ability to provide basis reporting, depending on the structure of the QI's accounts with the payor.

Relief from Reporting Penalties. Although information contained in the Administration's Fiscal Year 2009 Revenue Proposals indicates that, under regulations, a broker would not be penalized for failure to accurately report items of information that the broker is unable to obtain with reasonable efforts, it is not clear what will be considered to be a reasonable effort in any particular instance. While administrative relief is welcome, we believe that the term "reasonable efforts" should be clearly defined under the regulations. We also agree with SIFMA's recommendation that the statute should provide transitional relief from reporting penalties for two years after the reporting requirements take effect.