

June 26, 2007

Chairman Max Baucus
Ranking Member Charles Grassley
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

Re: Senate Finance Committee Basis Reporting Proposal

Dear Chairman Baucus and Ranking Member Grassley,

The National Association of Enrolled Agents (NAEA) appreciates the opportunity to comment on the Senate Finance Committee's proposal to impose basis reporting requirements for publicly-traded securities. As the organization representing the interests of 46,000 enrolled agents—the only tax practitioners whose competency and ethical behavior are attested to by the IRS—NAEA is committed to increasing industry professionalism, improving the integrity of the nation's tax administration system, and protecting taxpayers' rights to representation. Further, we believe that NAEA is well positioned to offer an informed perspective about the practical impact the committee's proposal could have on taxpayers, paid income tax return preparers, and the tax gap.

NAEA supports requiring brokers to include in information returns the adjusted bases of customers' applicable securities, as the requirement would likely result in both more accurate reporting of capital gains income and/or loss and less burden to individual taxpayers. For a variety of reasons, many of our clients struggle when asked to provide cost basis for securities they sold. Of particular concern are long-term holdings to which the client has made additional sporadic investments as well as mutual funds with reinvested long/short capital gains distributions and ordinary income distributions.

From all appearances, brokerage firms are well-placed to provide basis information—in fact a number of them already provide this information to their clients. Nonetheless, there will be administrative challenges to transferring the basis calculation responsibility from the taxpayer to the broker. If existing systems cannot track and calculate basis, brokers will need to establish such a system. Although we do not have an opinion on the currently-provided transition period, we strongly encourage the Committee to ensure that the period is of adequate length.

The taxpayer, while ultimately responsible for tracking the bases of her own securities, will in practice rely heavily on her broker to report the correct information to the IRS. To protect the taxpayer against inadvertent basis calculation errors on the part of the broker, we believe the taxpayer should have

the right to present IRS with a basis that differs from the broker-reported basis, provided the taxpayer can offer a reasonable case to support her calculation.

We would also like to suggest that the proposal may be strengthened by requiring taxpayers who were/are gifted securities to make a good faith effort to determine basis of the securities. Clearly the case of long ago gifts from a deceased person will make this exercise challenging, but the basis of a security is necessarily non-zero and a taxpayer is in a far better position than her broker to approximate basis.¹

One of the most significant difficulties both taxpayers and enrolled agents face when calculating basis is that brokers often do not have access to the correct basis information. This is often the case when a taxpayer transfers securities between brokers. Thus the requirement that basis information be transferred between brokers when securities are transferred from one broker to another will be critical to administering this proposal.

Owing to the complexity of the tax code and of specific taxpayers' investments, some basis calculation will be much more challenging than others. For instance, brokers may not report the correct basis if a transaction is considered a wash sale (under §1091), if dividends have been reinvested, or if corporate mergers or divisions affect shareholders' bases. Such situations are not rare, and they will require that IRS issue clear regulations to ensure that brokers have the information they need to properly report their customers' bases.

We commend the Finance Committee for taking steps to increase accurate reporting of income as part of a larger effort to increase compliance with existing tax law. The Chairman and Ranking Member have repeatedly stated that there is no single "silver bullet" solution to the tax gap. NAEA encourages the Finance Committee to consider other causes that contribute to the tax gap. A 2006 GAO study (*Paid Tax Return Preparers: In a Limited Study Chain Preparers Make Serious Errors*) estimates that more than half of individual income tax returns filed are prepared by a paid tax preparer.² In the same study, GAO found several instances of incompetent preparation by chain preparers, often

¹ Practitioners anecdotally report the IRS will assert a basis of zero for gifted property where there is no clear evidence of cost. But, reality says otherwise. Judge Learned Hand once wrote in the famous Cohan case (*Cohan v. Commissioner* (39 F.2d 540(2d Cir. 1930)) that the Tax Court's predecessor ("the Board") could not completely disallow business expenses merely because it was impossible to determine in the absence of records how much the taxpayer had spent. While that case involved business expenses, it appears the sentiments he espoused would carry over to these gifted securities. He stated, "But to allow nothing at all appears inconsistent with saying that something was spent. ... there was obviously some basis for computation, if necessary drawing upon the Board's personal estimates of the minimum of such expenses. ... there was basis for some allowance, and it was wrong to refuse any...It is not fatal that the result will inevitably be speculative; many important decisions must be such."

² Government Accountability Office, *Testimony Before the Committee on Finance, U.S. Senate: Paid Tax Return Preparers* (April 2006), p. 4.

resulting in large refund overclaims.³ Congress could act to improve competence and ethical standards in the tax preparation industry by enacting S. 1219, the Taxpayer Protection and Assistance Act. NAEA believes that by requiring an initial examination and continuing education for all paid tax preparers, Congress could bring more taxpayers into compliance by improving the accuracy of tax return preparation.

NAEA appreciates the opportunity to submit comments on the Senate Finance Committee's proposal to require basis reporting for securities transactions. Should you seek further clarification or explanation of our positions, please contact NAEA at 202-822-6232.

Sincerely,

A handwritten signature in cursive script that reads "Diana Thompson".

Diana Thompson, EA
President

cc: Kevin Brown, Acting Commissioner, Internal Revenue Service
Nina Olson, National Taxpayer Advocate

³ Ibid, p. 5.