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Wealth Advisor Solutions

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Open Letter to Members of Congress:

I write seeking your assistance in striking from the Tax Cuts and Jobs Act the provision of the Senate Finance Committee bill that would generally require taxpayers selling, gifting or otherwise disposing of securities to determine cost basis on a first-in, first-out (FIFO) basis.

Rather than supporting the objectives of tax reform to establish a simpler, fairer tax code built for growth, the mandatory FIFO provision would do the opposite: stymy economic growth by creating new barriers to efficient capital formation, needlessly complicate the financial lives of millions of American investors and unfairly favor registered investment funds over individual investors and other taxpayers.

Adopting mandatory FIFO would be disruptive and expensive, requiring brokers and their customers to undertake the highly burdensome task of determining the full purchase history of each position held in any security the customer sells. Brokers today generally do not have purchase records for their customer transactions prior to 2011. Given the major upgrades to broker recordkeeping and reporting systems that would be required, the mandatory FIFO provision cannot possibly be implemented by the proposed effective date for dispositions of securities on or after January 1, 2018.

Scored at generating $2.4 billion of new tax revenue over ten years, mandatory FIFO would contribute exceedingly little to the $1.5 trillion estimated cost of tax reform. This tiny contribution does not begin to justify the distortive effects of mandatory FIFO on investor behavior, the resulting harm to market efficiency and economic growth, the adverse effects on tax system equity and the substantial cost to implement and administer this proposed tax change.

We feel there are some other anti-competitive and unwarranted elements in this provision that members of Congress should be gravely concerned about. Specifically -

- When the Senate proposed a carve-out provision that protected the institutional fund companies and ETF providers while ignoring the retail investor class, <u>they created an uneven playing field that is heavily tilted against retail investors</u>. Through this provision, the institutional investor will be afforded a significant advantage as they may exit any tax lot they wish. With the freedom to select tax lots, the institutional investors can sell at will, whereas the retail consumer will be locked-up due to tax costs associated with their low-basis FIFO shares. This sort of unfair playing field is analogous to suggesting institutional investors can trade commission-free whereas retail investors must always pay commission. The provision creates an enormously unfair and artificial trading barrier that will heavily disadvantage retail investors.

- With this barrier in place, end-investors will likely open up different brokerage accounts or have paper certificates issued to them. In both cases, there is no reasonable method to enforce or monitor this condition. This will drive up operational costs for advisors and custodians which will ultimately be passed through to the end investors. And by exploiting this loophole, the revenue projections are likely to fall even shorter than expected.

- By adding friction to the retail investor's ability to liquidate securities through a FIFO provision, one should assume that there will be less selling and thus less liquidity – and efficiency - in our capital markets. This also means that retail investors will be less inclined to eliminate assets in an attempt to seek diversification. This will ultimately lead to concentrated and highly appreciated holdings in client portfolios which runs in stark contrast to tried and true investment principles of diversification, rebalancing and buy-low/sell high for retail investors. This introduces the potential of an enormous loss during a market correction as well as introducing excessive levels of portfolio risk – all while stifling the efficiency of the capital markets.

- This provision disproportionally burdens older investors as they approach retirement and will erode retirement savings through unplanned and unbudgeted taxes. Older investors likely have a more extensive tax history and on average maintain a lower cost basis than younger investors. This FIFO penalty also represents an unplanned expense that retirees had not budgeted for – which will erode taxable retirement savings at a time when retirees have very little time to recoup this new, unanticipated retirement gap.

- This provision also disproportionally disadvantages middle- and upper-income investors who are more likely to hold FIFO-eligible securities. Contrast that with ultra-high net worth and institutional investors who frequently hold real estate, hedge funds and other sheltered 'accredited investor' assets, which can be exempted from FIFO provisions as a result of the Senate's proposed carve-out clauses.

I respectfully urge your assistance in acting to strike mandatory FIFO from the Tax Cuts and Jobs Act while it is in the reconciliation process.

Thank you for your consideration.

Sincerely,

Barrett W Ayers II
Chief Solutions Officer
Adhesion Wealth Advisor Solutions