PART IV: STRADDLES AND OTHER TRANSACTIONS

7587. What is a "tax straddle"?

A "tax straddle" is the simultaneous ownership of offsetting interests (i.e., "positions") in actively traded personal property. For this purpose, an "interest" may be ownership of the property itself or may be a regulated futures contract, a futures contract other than a regulated futures contract, a forward contract, or an option. Interests owned by an investor's spouse, partnership, S corporation, or trust of which the investor is a deemed owner are treated as owned by the investor for purposes of determining whether a tax straddle exists.[1]

Interests (i.e., positions) are offsetting if the risk of loss from owning any particular interest is substantially reduced by reason of the ownership of such other interest (or interests). But risk reduction through mere diversification is not considered to be substantial if the positions are not balanced. Interests may be treated as offsetting even though they or the underlying personal properties are not the same kind (e.g., ownership of silver and a futures contract to sell the same amount of silver; or a long futures contract for silver and a short futures contract for silver coins). If positions are not equally offsetting, the tax straddle rules will apply, under regulations yet to be issued, only to the extent the positions are balanced.[2]

Under the following circumstances, two or more positions will be *presumed* to be offsetting, unless the investor is able to show to the contrary:[3] (1) the positions are in the same personal property and the value of one or more such positions ordinarily varies inversely with the value of one or more of other such positions; (2) the positions are in debt instruments of similar maturity (or other debt instruments described in future regulations) *and* the value of one or more such positions ordinarily varies inversely with the value of one or more of other such positions; (3) the positions are marketed as offsetting positions; or (4) the aggregate margin requirement for such positions is lower than the sum of the margin requirements for each such position if each position were held separately.

Direct ownership of stock may be exempted from the straddle rules. See Q 7588 for an explanation of when the rules will apply.

Section 1256 Contracts	**Non-Section 1256 Property**
Regulated futures contracts	Stock options
Nonequity option contracts (see Q 7576)	Other equity options (see Q 7575)

1. IRC Secs. 1092(c), 1092(d)(4).
2. IRC Sec. 1092(c); General Explanation – ERTA, p. 288.
3. See IRC Sec. 1092(c)(3).

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Section 1256 Contracts	**Non-Section 1256 Property**
Foreign currency contracts Dealer equity options	Direct ownership of stock — but only when at least one offsetting position is: 1) an option (other than a qualified covered call option) on such stock or on substantially similar stock or securities; 2) substantially similar property; or 3) stock of certain corporations which take positions that offset positions held by Shareholders (see Q 7588) Forward contracts Other *actively traded personal property* which is not a Section 1256 contract Securities futures contracts (see Q 7580)

7588. When will direct ownership of stock be subject to the tax straddle rules?

Direct ownership of stock (i.e., ownership of the stock certificates) is considered to be ownership of personal property for purposes of the tax straddle rules if such stock is of a type that is actively traded and at least one of the positions offsetting such stock is a position with respect to such stock or substantially similar or related property.[1] (This limited definition does not apply for purposes of determining whether a straddle constitutes a conversion transaction (See Q 7604 and Q 7605).[2]

In the American Jobs Creation Act of 2004, Congress repealed the pre-existing exclusion from the tax straddle rules for most direct ownership of stock. The statutory rule expands on previously proposed regulations that limited the scope of the statutory exclusion. Under the proposed regulations, personal property included any stock that is actively traded and that is part of a straddle in which at least one of the offsetting positions is a position with respect to substantially similar or related property other than stock. A position with respect to substantially similar or related property other than stock did not include direct ownership of stock or a short sale of stock, but included any other position with respect to substantially similar or related property. Thus, under the proposed regulations, stock and an equity swap with respect to property that is substantially similar or related to that stock could constitute a straddle for purposes of IRC Section 1092.[3]

The IRS has not yet issued any guidance on the rules, but the 2004 change eliminated the ability to hold offsetting positions in a target and an acquiring corporation's stock without being subject to the tax straddle rules, including termination of holding periods.

1. IRC Sec. 1092(d)(3)(A).
2. IRC Secs. 1258(c)(2)(B), 1258(d)(1).
3. Prop. Treas. Reg. §1.1092(d)-2.

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Stock in a corporation that was formed or availed of to take positions in personal property that offset positions taken by shareholders of such corporation will also be subject to the straddle rules regardless of whether the stock is actively traded.[1]

Stock that is part of a straddle at least one of the offsetting positions of which is a securities futures contract (see Q 7580) with respect to the stock or substantially identical stock will be subject to the straddle rules.[2] The regulations under IRC Section 1092(b), applying the principles of IRC Section 1233(b) and IRC Section 1233(d) (regarding the determination of short-term and long-term losses) to positions in a straddle, will also apply (see Q 7593).[3] These rules are demonstrated in the following example from H.R. Conf. Rep. No. 106-1033 (CRTRA 2000):

> *Example*: Assume a taxpayer holds a long-term position in actively traded stock (that is a capital asset in the taxpayer's hands) and enters into a securities futures contract to sell substantially identical stock (at a time when the position in the stock has not appreciated in value so that the constructive sale rules of IRC Section 1259 do not apply). The taxpayer has a straddle. Any loss on closing the securities futures contract will be a long-term capital loss.

The IRS has determined that investment "units" consisting of stock and a future payment right (that varied inversely with the value of the stock and that was found to be a "cash settlement put option") constituted a straddle when the positions were held simultaneously.[4] The Service has also privately ruled that two positions consisting of (1) a put option that was part of a "costless collar" (i.e., the purchase of a cash-settlement put option and the sale of a cash-settlement call option), and (2) shares of the underlying stock, constituted a straddle under IRC Section 1092(c). Similarly, the call option, which was part of the same costless collar, and the shares of the underlying stock also constituted a straddle.[5] See also FSA 200150012 (a straddle existed where the corporate taxpayer directly owned shares of a company (i.e., the long position) and had also issued purported debt instruments in which the value of the instruments was linked to the price of the underlying stock).

The tax treatment of a straddle that includes a position (or positions) in stock depends on the overall make-up of the straddle and whether the straddle constitutes a conversion transaction. For details, see Q 7593, Q 7604, and Q 7605.

7589. What is a "qualified covered call option"?

A covered call option is a call option (See Q 7555) written (i.e., granted) by an investor on stock that is owned by the investor or acquired by the investor in connection with the writing of the call option. Because the writing of a covered call option will not substantially reduce the investor's risk of loss with respect to the underlying stock unless the option is deep-in-the-money, the IRC provides that writing at-the-money and non-deep-in-the-money call options on stock owned or acquired by the investor (i.e., "qualified covered call options") is generally

1. IRC Sec. 1092(d)(3)(B)(ii); Prop. Treas. Reg. §1.1092(d)-2(a)(2).
2. H.R. Conf. Rep. No. 106-1033 (CRTRA 2000). See IRC Sec. 1092(d)(3)(B)(i)(II).
3. H.R. Conf. Rep. No. 106-1033 (CRTRA 2000).
4. Rev. Rul. 88-31, 1988-1 CB 302.
5. Let. Rul. 199925044.

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excluded from straddle treatment.[1] (A call option is "in-the-money" when the striking price of the option is below the market price of the underlying stock). A qualified covered call option also will generally not be subject to the capitalization requirements of IRC Section 263(g).[2]

But where the underlying stock and one or more qualified covered call options are part of a larger straddle, the overall straddle does receive straddle treatment.[3] For example, the IRS ruled that buying a put on the same underlying stock on which the taxpayer wrote a qualified covered call option did create a larger straddle subject to straddle treatment.[4]

The holding period of any stock underlying a qualified covered call option written by an investor where the strike price is less than the applicable stock price will be tolled during the period that such option is open. Furthermore, any loss realized by an investor on a qualified covered call option that has a striking price that is less than the applicable stock price (as defined below) will be treated as *long-term* capital loss if, at the time the loss is realized, a sale of the underlying stock would have resulted in a long-term capital gain.[5] For most purposes, the holding period requirement for long-term capital gain treatment is "more than one year"[6] (See Q 608 for the treatment of capital gains and losses).

A call option is a "qualified covered call option" if: (1) it is an exchange-traded (i.e., listed) option *or* under the regulations, an over-the-counter option meeting certain requirements (see *Over-the-counter options*, below); (2) it is written by the investor on stock held or acquired in connection with writing the call; (3) the term of the call is longer than 30 days but no longer than 33 months; (4) gain or loss with respect to such call option is not ordinary income or loss; and (5) the call's striking price is not lower than the *lowest qualified bench mark* for that option (i.e., the option is not deep-in-the-money). (If the investor is an options dealer, the call must not be written in the ordinary course of his business).[7]

For purposes of determining if an option is a qualified covered call option, the "lowest qualified bench mark" is generally the highest available striking price for such option which is less than the *applicable stock price* of the underlying stock. But several special rules apply as follows:

1. If the term of the call option is more than 90 days and its striking price is greater than $50, then the "lowest qualified bench mark" is the *second highest* available striking price that is less than the applicable stock price.

2. If the applicable stock price is $25 or less and the lowest qualified bench mark would otherwise be less than 85 percent of the applicable stock price, the "lowest qualified bench mark" will be treated as equal to the amount which is 85 percent of the applicable stock price.

1. IRC Sec. 1092(c)(4).
2. See General Explanation – TRA '84, pp. 309-310.
3. IRC Sec. 1092(c)(4)(A)(ii).
4. Rev. Rul. 2002-66, 2002-2 CB 812.
5. IRC Sec. 1092(f).
6. IRC Sec. 1222(3).
7. IRC Secs. 1092(c)(4)(B), 1092(c)(4)(C); Treas. Reg. §1.1092(c)-1.

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3. If the applicable stock price is $150 or less, and the lowest qualified bench mark would otherwise be more than $10 less than the applicable stock price, then the "lowest qualified bench mark" is the applicable stock price *reduced by* $10.[1]

4. If the term of the call option is more than 12 months, the applicable stock price is multiplied by an adjustment factor found in Treasury Regulation Section 1.1092(c)-4(e).

Under the usual circumstances, the "applicable stock price" is the closing price of the optioned stock on the most recent day such stock was traded *before* the date on which the option was written. But if the opening price of the optioned stock on the day the option was written is greater than 110 percent of the closing price on the last previous trading day, the "applicable stock price" is such opening price.[2]

7590. What are "flex options"?

Flex options are customized options that allow investors to customize key contract terms, including strike prices. But the determination of the "lowest qualified bench mark" for standardized options is based upon the striking prices for standardized options, not for equity options with flexible terms (i.e., flex options).[3] Thus, certain taxpayers (primarily institutional and other large investors) can engage in transactions that would otherwise be unavailable to them, and other investors can continue to do business without regard to the existence of the institutional product.

Currently, exchange rules provide for $2.50 bench marks (i.e., strike prices at $2.50 intervals) for standardized options on stocks trading between $5 and $25, $5 bench marks for options on stocks trading between $25 and $200 per share, and $10 bench marks for options on stocks trading at more than $200. Apparently, if these bench marks are modified by the exchanges or the exchanges otherwise change their practices, the IRS has broad authority to revise the foregoing rules.[4]

Regardless of the foregoing rules, a covered call option is *not* treated as qualified (and a tax straddle does exist) *if* the gain from the disposition of the underlying stock is includable in the investor's gross income for a tax year subsequent to the tax year in which either the call option was closed or the stock was disposed of at a loss *and* the stock or option was not held for 30 days or longer following the date the call was closed or the stock was disposed of. However, the rules discussed above, which require the tolling of the holding period of the underlying stock and which treat loss as long-term loss if there would have been long-term gain on a sale of the underlying stock, continue to apply.[5]

1. IRC Sec. 1092(c)(4)(D).
2. IRC Sec. 1092(c)(4)(G).
3. See Treas. Reg. §1.1092(c)-2(b).
4. See IRC Sec. 1092(c)(4)(H); General Explanation – TRA '84, p. 310.
5. IRC Sec. 1092(c)(4)(E).

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It is unclear whether a qualified covered call option can constitute a conversion transaction (See Q 7604). If so, it may be subject to the additional rules set forth in Q 7605.

7591. When can an equity option with flexible terms be a qualified covered call option?

Equity options with flexible terms. Unlike equity options with standardized terms, equity options with flexible terms can have strike prices at other than fixed intervals and can have expiration dates other than standardized expiration dates. Under the regulations, equity options with flexible terms may be qualified covered call options if they satisfy certain requirements. Specifically, an equity option with flexible terms is a qualified covered call option *only if* (1) the option meets the requirements of IRC Section 1092(c)(4)(B) (as outlined in Q 7590); (2) the only payments permitted with respect to the option are a single fixed premium paid no later than five business days after the day on which the option is granted, and a single fixed strike price stated as a dollar amount that is payable entirely at (or within five business days of) exercise; (3) an equity option with standardized terms is outstanding for the underlying equity; and (4) the underlying security is stock in a single corporation.[1] An equity option with standardized terms means an equity option that is traded on a national securities exchange (i.e., a listed option) and that is not an equity option with flexible terms.[2]

For purposes of applying the general rules, the bench mark for an equity option with flexible terms will be the same as the bench mark for an equity option with standardized terms on the same stock having the same applicable stock price.[3]

7592. When can an over-the-counter option qualify as a qualified covered call option?

Under the regulations, certain over-the-counter options may also qualify as qualified covered call options. A *qualifying over-the-counter option* is an equity option that is not traded on a national securities exchange registered with the Securities and Exchange Commission *and* is entered into with a person registered with the Securities and Exchange Commission as a broker-dealer or alternative trading system.[4] A qualifying over-the-counter option must meet the same requirements outlined in Q 7591 for equity options with flexible terms.[5]

7593. How is a tax straddle taxed?

The tax treatment applicable to a tax straddle depends on the types of property that make up the positions in the straddle. It will also depend on whether substantially all of the taxpayer's expected return from the investment is attributable to the time value of the taxpayer's net investment in the transaction. (See the discussion of conversion transactions in Q 7596). If the straddle is made up solely of IRC Section 1256 contracts (See Q 7587), it will be taxed as explained in Q 7598. If the straddle is a "mixed" straddle, it will be taxed according to the rules

1. Treas. Reg. §1.1092(c)-2(c)(1).
2. Treas. Reg. §1.1092(c)-4(b).
3. See Treas. Reg. §1.1092(c)-2(c)(2).
4. Treas. Reg. §1.1092(c)-3(a).
5. Treas. Reg. §1.1092(c)-3(b).

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explained in Q 7599. If the straddle qualifies as an "identified tax straddle," it is subject to the rules explained in Q 7600.

If none of the foregoing exceptions or elections applies or has been made, the straddle will generally be taxed under the *loss deferral*, *wash sale*, and *short sale* rules explained at Q 7594. Straddles are also subject to the requirement that interest and carrying charges allocable to property that is part of the straddle be capitalized.[1]

The IRS stated that it may be permissible for a taxpayer to identify which shares of stock are part of a straddle and which shares are used as collateral for a loan using appropriately modified versions of Treasury Regulation Section 1.1012-1(c)(2) or Temporary Treasury Regulation Section 1.1092(b)-3T(d)(4) in order to establish that the shares that are part of the collar are not used as collateral for the loan.[2]

These rules apply to all "dispositions" of positions in a straddle regardless of whether such disposition is by sale, exchange, cancellation, lapse, expiration, or any other termination of interest with respect to a position.[3] Apparently, "other terminations" would include exercise, delivery, assignment, and offset.

7594. What rules regarding loss deferral and wash sales apply in determining how a tax straddle is taxed?

If the owner of a straddle disposes of less than all the positions making up the straddle, any loss realized with respect to the position (or positions) disposed of may be recognized for tax purposes only to the extent that the loss exceeds the aggregate amount of *unrecognized gain*, if any, on (1) positions in the straddle that offset the position(s) disposed of at a loss, (2) successor positions (if any), or (3) any positions that are offsetting to such successor position(s). *Unrecognized gain*, for this purpose, is (a) the amount of gain that would result from the sale of the position at fair market value on the last business day of the year, if the position is still held at the close of the year, or (b) the amount of realized but unrecognized gain, if gain was realized on that position during the tax year, but for some reason was not recognized for tax purposes in that year.[4]

Basically, a "successor position" is a new straddle position that is acquired within 30 days before, or 30 days after, the original position was disposed of at a loss and that replaces that original position in the straddle. More specifically, a "successor position" is a position (call it "P1") that is offsetting to another position ("P2") (or would have been offsetting to P2 had P2 been held at the time P1 was entered into) if (i) P2 was offsetting to the loss position disposed of, (ii) P1 is entered into during a period which begins 30 days before, and ends 30 days after, the disposition of the loss position, and (iii) P1 is entered into no later than 30 days after the loss position is no longer included in the straddle.[5] (The effect of establishing

1. IRC Sec. 263(g).
2. See Let. Rul. 199925044.
3. Temp. Treas. Reg. §1.1092(b)-5T(a).
4. IRC Secs. 1092(a)(1), 1092(b)(1); Temp. Treas. Reg. §1.1092(b)-1T(a).
5. Temp. Treas. Reg. §1.1092(b)-5T(n) (as amended by Ann. 85-91, 1985-26 IRB 39).

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a successor position to a loss position disposed of is analogous to the general wash sale rule explained in Q 7534).

Any loss in excess of the amount allowed to be recognized under these rules (i.e., the amount of loss disallowed as a deduction) is carried forward and treated as if sustained in the succeeding tax year (in which it will again be subject to these deferral rules). A capital loss deferred under these rules will retain its character as a capital loss in the carryover year (even if loss with respect to a successor position would give rise to an ordinary loss).[1] See Q 608 for the treatment of capital gains and losses.

Losses were denied to an investor who participated in a stock forwards program in which he incurred significant tax losses in one year while deferring the corresponding gain into future taxable years by holding instruments in the form of a purported "straddle." The appeals court upheld the Tax Court, stating that the purported "straddle" trades lacked economic substance and did not have any "practical economic effects other than the creation of income tax losses." Accordingly, the losses were properly disallowed.[2]

7595. How is it determined whether a gain or loss on the disposition of a tax straddle is long-term or short-term?

Short sale rules. For purposes of determining whether a gain or loss on the disposition of a straddle position is long-term or short-term, two rules similar to the general short sale rules (see Q 7525) apply. First, unless a position was held by the taxpayer for a period of time at least equal to the long-term capital gain holding period before a straddle including that position was established, the holding period of that position will be treated as beginning no earlier than the date on which the taxpayer no longer holds, directly or indirectly, an offsetting position with respect to that position. Second, the loss on the disposition of a straddle position (or positions) will, regardless of the holding period of such position, be treated as *long-term* capital loss *if* on the date such loss position was entered into the taxpayer held, directly or indirectly, one or more offsetting positions *and* all gain or loss on one or more positions in the straddle would have been treated as long-term capital gain or loss had such position(s) been disposed of on the day the loss position was entered into.[3]

7596. How do the conversion transaction rules apply in determining how a tax straddle is taxed?

A portion of any gain recognized upon disposition or other termination of a straddle that is part of a *conversion transaction* (see Q 7604) may be treated as ordinary income. A straddle will be subject to these rules if substantially all of the taxpayer's expected return from the investment is attributable to the time value of the taxpayer's net investment in the transaction.[4] See Q 7604 and Q 7605 for the definition and tax treatment of conversion transactions.

1. IRC Sec. 1092(a)(1)(B). Temp. Treas. Regs. §§1.1092(b)-1T(b), 1.1092(b)-1T(c).
2. *Keeler v. Comm.*, 243 F.3d 1212 (10th Cir. 2001) (concerning pre-DEFRA law).
3. IRC Sec. 1092(b)(1); Temp. Treas. Reg. §1.1092(b)-2T.
4. IRC Sec. 1258(c).

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7597. How are interest and carrying charges allocable to personal property that is part of a tax straddle treated?

Interest and carrying charges properly allocable to personal property that is part of a straddle must be capitalized.[1] The purpose of this rule is to coordinate the character and timing of items of income and loss attributable to a taxpayer's positions that are part of a straddle.[2]

According to proposed regulations, for purposes of the straddle interest and carrying charges rules, "personal property" means property, whether or not actively traded, that is not real property. For this purpose a position in personal property may itself be property. But in general, a position in personal property is not property of a taxpayer unless the position confers substantial rights on the taxpayer.[3]

Personal property includes (1) a stockholder's ownership of common stock, (2) a holder's ownership of a debt instrument, and (3) either party's position in a forward contract or conventional swap agreement. Personal property does *not* include a position that imposes obligations but does not confer substantial rights on the taxpayer. Thus, the obligor's position in a debt instrument generally is not personal property even though the obligor may have the typical rights of a debtor. But the obligor on a debt instrument has a position in any personal property underlying the debt instrument.[4]

A put or call option imposes obligations but does not confer substantial rights on the grantor, whether or not the option is cash-settled.[5]

Interest and carrying charges properly allocable to personal property that is part of a straddle means the excess of interest and carrying charges (as defined below) over the allowable income offsets (as defined below).[6] "Interest and carrying charges" are: (1) otherwise deductible amounts paid or accrued with respect to *indebtedness or other financing incurred or continued to purchase or carry personal property that is part of a straddle* (see below); (2) indebtedness or other financing incurred or continued to purchase or carry personal property that is part of a straddle; and (3) otherwise deductible amounts paid or incurred to carry personal property that is part of a straddle. "Interest" includes any amount paid or incurred in connection with personal property used in a short sale. Interest and carrying charges include otherwise deductible payments or accruals on debt or other financing issued or continued to purchase or carry personal property that is part of a straddle, or financial instruments that are part of a straddle or that carry part of a straddle. Interest and carrying charges subject to capitalization also include fees or expenses paid or incurred in connection with acquiring or holding personal property that is part of a straddle. This would include, but not be limited to, fees or expenses incurred to purchase, insure, store, maintain, or transport the personal property.[7]

1. IRC Sec. 263(g)(1).
2. Prop. Treas. Reg. §1.263(g)-1(a).
3. Prop. Treas. Reg. §1.263(g)-2(a).
4. Prop. Treas. Reg. §1.263(g)-2(a)(1).
5. Prop. Treas. Reg. §1.263(g)-2(a)(2).
6. Prop. Treas. Reg. §1.263(g)-3(a).
7. IRC Sec. 263(g)(2); Prop. Treas. Reg. §1.263(g)-3(b).

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Indebtedness or other financing incurred or continued to purchase or carry personal property that is part of a straddle includes indebtedness or other financing (1) the proceeds of which are used directly or indirectly to purchase or carry personal property that is part of the straddle, (2) that is secured directly or indirectly by personal property that is part of the straddle, and (3) the payments on which are determined by reference to payments with respect to the personal property or the value of, or change in value of, the personal property.[1]

Financial instruments that are part of a straddle or that carry part of a straddle include

(1) a financial instrument that is part of the straddle;

(2) a financial instrument that is issued in connection with the creation or acquisition of a position in personal property if that position is part of the straddle;

(3) a financial instrument that is sold or marketed as part of an arrangement that involves a taxpayer's position in personal property that is part of the straddle *and* that is purported to result in either economic realization of all or part of the appreciation in an asset without simultaneous recognition of taxable income or a current tax deduction (for interest, carrying charges, payments on a notional principal contract, or otherwise) reflecting a payment or expense that is economically offset by an increase in value that is not concurrently recognized for tax purposes or has a different tax character (e.g., an interest payment that is economically offset by an increase in value that may result in a capital gain in a later tax period).

Any other financial instrument may also be included if the totality of the facts and circumstances supports a reasonable inference that the issuance, purchase, or continuation of the financial instrument by the taxpayer was intended to purchase or carry personal property that is part of the straddle.[2]

Allowable income offsets. The allowable income offsets are (1) the amount of interest (including original issue discount) includable in gross income for the taxable year with respect to such personal property; (2) any amount treated as ordinary income with respect to such personal property for the taxable year; (3) the excess of any dividends includable in gross income with respect to such personal property for the taxable year over the amount of any deductions allowable with respect to such dividends; (4) any amount that is a payment with respect to a security loan includable in income with respect to the personal property for the taxable year; and (5) any amount that is a receipt or accrual includable in income for the taxable year with respect to a financial instrument to the extent the financial instrument is entered into to purchase or carry the personal property.[3]

Allocation Rules. Interest and carrying charges paid or accrued on debt or other financing issued or continued to purchase or carry personal property that is part of a straddle are allocated in the following order:

1. Prop. Treas. Reg. §1.263(g)-3(c).
2. Prop. Treas. Reg. §1.263(g)-3(d).
3. Prop. Treas. Reg. §1.263(g)-3(e).

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(1) to personal property that is part of the straddle purchased, directly or indirectly, with the proceeds of the debt or other financing;

(2) to personal property that is part of the straddle and directly or indirectly secures the debt or other financing; *or*

(3) if all or a portion of such interest and carrying charges is determined by reference to the value or change in value of personal property, to such personal property.[1]

"Fees and expenses" (described above) are allocated to the personal property, the acquisition or holding of which resulted in the fees and expenses being paid or incurred. In all other cases, interest and carrying charges are allocated to personal property that is part of a straddle in the manner that under all the facts and circumstances is most appropriate.[2]

Coordination with other provisions. In the case of a short sale, IRC Section 263(g) applies after IRC Section 263(h) (dealing with payments in lieu of dividends in connection with short sales).[3] In addition, IRC Section 263(g) applies after IRC Section 1227 (dealing with the deferral of interest deduction allocable to accrued market discount) and also applies after IRC Section 1282 (dealing with the deferral of interest deduction allocable to certain accruals on short-term indebtedness). Furthermore, capitalization under IRC Section 263(g) applies before loss deferral under IRC Section 1092.[4]

7598. How is a tax straddle taxed if it is made up solely of Section 1256 contracts?

If a tax straddle is made up solely of regulated futures contracts, foreign currency contracts, and nonequity option contracts (i.e., "IRC Section 1256 contracts"), each contract is generally taxed independently under the mark-to-market tax rules explained in Q 7586, except that if the investor takes delivery under, or exercises, any of the contracts making up the straddle, all the contracts in the straddle are deemed to have been terminated on the day of the delivery or exercise. That is, all contracts will be deemed to have been sold or otherwise terminated on that day.[5]

A tax straddle made up solely of IRC Section 1256 contracts is excepted from the loss deferral, wash sale, and short sale rules of IRC Section 1092 and the capitalization provisions of IRC Section 263(g). See Q 7593 for an explanation of those rules.[6]

A portion of any gain recognized upon disposition or other termination of a straddle that is part of a *conversion transaction* (See Q 7604) may be treated as ordinary income. A straddle will be subject to these rules if substantially all of the taxpayer's expected return from the investment

1. Prop. Treas. Reg. §1.263(g)-4(a).
2. Prop. Treas. Reg. §1.263(g)-4(a).
3. See IRC Secs. 263(g)(4)(A) and 263(h)(6).
4. Prop. Treas. Reg. §1.263(g)-4(b).
5. IRC Secs. 1256(a), 1256(c)(2).
6. IRC Sec. 1256(a)(4).

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is attributable to the time value of the taxpayer's net investment in the transaction.[1] See Q 7604 and Q 7605 for the definition and tax treatment of conversion transactions.

Although IRC Section 1256 contracts are excluded from the definition of an *appreciated financial position* under IRC Section 1259(b)(2)(B) (see Q 7606), depending on the taxpayer's other holdings, it appears that a constructive sale could result from entering into an IRC Section 1256 contract to deliver property that is the same as or substantially identical to an appreciated financial position held by the taxpayer (see Q 7606 to Q 7608).[2]

7599. What is a "mixed" straddle? What tax choices are available to the owner of a "mixed" straddle?

A "mixed" straddle is a tax straddle (see Q 7587) made up of one or more IRC Section 1256 contracts (i.e., regulated futures contracts, foreign currency contracts, and nonequity options) and at least one other position that is not an IRC Section 1256 contract, *but only if* each position making up the straddle is clearly identified in the investor's records as being part of a mixed straddle within the time period prescribed by the IRC and regulations.[3]

Basically, an owner of a mixed straddle has three initial choices to make:

(1) The owner may elect to exclude the IRC Section 1256 contract (or contracts) from the mark-to-market tax rules explained in Q 7586 and have all the positions in the straddle taxed under the loss deferral, wash sale, and short sale rules of IRC Section 1092 (See Q 7593). But this election is available only where the investor has identified in records all the positions in the mixed straddle before the close of the day on which the first IRC Section 1256 contract forming part of the straddle is acquired.[4]

(2) If the mixed straddle also qualifies as an "identified tax straddle," the owner may elect (subject to the conditions described in (1), above) to exclude the IRC Section 1256 contract (or contracts) from the mark-to-market tax rules and further elect to have all positions in the straddle (including the IRC Section 1256 contracts) taxed under the rules that apply to "identified tax straddles" (See Q 7600).

(3) The owner may choose not to make either election described in (1) or (2), above, in which case the owner will be taxed as discussed in Q 7601.

A portion of any gain recognized upon disposition or other termination of a straddle that is part of a *conversion transaction* (See Q 7604) may be treated as ordinary income. A straddle will be subject to these rules if substantially all of the taxpayer's expected return from the investment is attributable to the time value of the taxpayer's net investment in the transaction.[5] See Q 7604 and Q 7605 for the definition and tax treatment of conversion transactions.

1. IRC Sec. 1258(c).
2. See IRC Secs. 1259(c)(1)(C), 1259(c)(1)(E).
3. IRC Sec. 1256(d); Temp. Treas. Reg. §1.1092(b)-5T(e).
4. IRC Sec. 1256(d). See General Explanation – TRA '84, p. 317.
5. IRC Sec. 1258(c).

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7600. How is a mixed straddle taxed if it qualifies and is designated as an "identified tax straddle"?

Assuming the straddle qualifies (see Q 7603), the owner of a mixed straddle who has elected to have the IRC Section 1256 contract positions in the straddle excluded from the mark-to-market tax rules may also elect to have the tax straddle taxed as an "identified straddle."[1] (Note that this election does *not* create what the regulations refer to as an "IRC Section 1092(b)(2) identified mixed straddle." These are discussed in Q 7602).

If this election is made, the straddle will not be subject to the loss deferral and wash sale rules discussed in Q 7593. Instead, any loss with respect to a position in the straddle (including the IRC Section 1256 contract positions) will be treated as sustained no earlier than the day on which all positions making up the straddle are disposed of.[2] The tax straddle short sale rules continue to apply. For details, see Q 7593 and Q 7603. The application of the constructive sale rules of IRC Section 1259 to identified straddles is discussed in Q 7603.

An election to remove the IRC Section 1256 contracts from the mark-to-market tax rules is necessary in order for a mixed straddle to be taxed as an identified straddle because without this election the mixed straddle rules discussed in Q 7601 will control.

7601. How is a mixed straddle taxed if there is no election to remove the regulated futures contracts from the mark-to-market tax rules?

If the owner of a mixed straddle does not elect to remove the IRC Section 1256 contract positions from the mark-to-market tax rules, gain or loss on each IRC Section 1256 contract in the straddle is determined under the mark-to-market tax rules (see Q 7577 and Q 7586). Gain or loss on each of the other positions of the straddle is determined under the general tax rules. But whenever a straddle position is disposed of (or deemed disposed of, as in the case of an IRC Section 1256 contract), the loss deferral, wash sale, and short sale rules of IRC Section 1092 (see Q 7593) are applied to determine whether and in what manner that gain or loss may be recognized for income tax purposes.

The short sale rules that apply to mixed straddles will generally have the effect of recharacterizing short-term losses on non-IRC Section 1256 positions of the mixed straddle as 60 percent long-term and 40 percent short-term.[3] Although the owner of a mixed straddle may avoid this result by making the election to exclude the IRC Section 1256 contracts from the mark-to-market rules, doing so will forfeit the 60/40 percent treatment of gains on the IRC Section 1256 contract positions (see Q 7599). But if desirable, it is possible to avoid the loss recharacterization rule while retaining 60/40 percent treatment for mixed straddle net gains derived from IRC Section 1256 contracts by electing to be taxed under the "straddle-by-straddle identification" rules or the "mixed straddle account" rules prescribed by the IRC and defined by regulation. (Remember, making either of these elections will not avoid the loss deferral and wash sale rules that apply to tax straddles generally).

1. IRC Sec. 1092(a)(2)(B).
2. IRC Sec. 1092(a)(2)(A)(ii).
3. Temp. Treas. Reg. §1.1092(b)-2T(b)(2). See General Explanation – TRA '84, p. 317.

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A portion of any gain recognized upon disposition, or other termination of a straddle that is part of a *conversion transaction* (see Q 7605), may be treated as ordinary income. A straddle will be subject to these rules if substantially all of the taxpayer's expected return from the investment is attributable to the time value of the taxpayer's net investment in the transaction.[1] See Q 7604 and Q 7605 for the definition and tax treatment of conversion transactions.

While the Internal Revenue Code does not plainly specify the application of the constructive sale rules of IRC Section 1259 to mixed straddles, it apparently is the intent of Congress that mixed straddles under IRC Section 1092(b)(2) will be subject to the rules for constructive sales of an appreciated financial position under IRC Section 1259, generally resulting in immediate gain recognition, the start of a new holding period, and an adjustment to basis (unless certain requirements are met for closing out the constructive sale transaction)[2] (see Q 7606 to Q 7608).

The Blue Book states that where either position in such an identified transaction is an appreciated financial position and a constructive sale of that position results from acquiring the second position, Congress intended that the constructive sale would be treated as having occurred immediately before the identified transaction. It adds that the constructive sale will not prevent qualification of the transaction as an identified straddle transaction. It is also the intent of Congress that future regulations will clarify the extent to which straddle transactions will be subject to or excepted from the constructive sale provisions.[3] Future regulations may clarify the manner in which these rules may be applied to mixed straddles.

Mixed Straddle Accounts

A taxpayer who owns mixed straddles may elect to establish one or more mixed straddle accounts for the purpose of determining gains and losses on positions includable in such account.[4] Because the mixed straddle account rules are designed to accommodate taxpayers who have such a large volume of transactions that identification of specific mixed straddles is impractical, the rules are beyond the scope of this book. For details on the mixed straddle account rules, see Temporary Treasury Regulation Section 1.1092(b)-4T.[5] The carryback rules of IRC Section 1212(c) were held applicable to the IRC Section 1256 contract leg of a mixed straddle account.[6]

7602. What are the "straddle-by-straddle" identification rules and how do they impact the tax treatment of a mixed straddle if there is no election to remove the regulated futures contracts from the mark-to-market tax rules?

Regulations use the term "identified mixed straddle" to refer to those straddles for which the taxpayer has elected "straddle-by-straddle identification." To avoid confusion, this discussion

1. IRC Sec. 1258(c).
2. General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), p. 176-177 (the 1997 Blue Book).
3. See 1997 Blue Book, p. 177.
4. IRC Sec. 1092(b)(2); Temp. Treas. Reg. §1.1092(b)-4T.
5. See also General Explanation – TRA '84, pp. 319-321.
6. See *Roberts v. U.S.*, 734 F.Supp. 314 (D.C. Ill. 1990).

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will refer to straddles for which this election has been made as "mixed straddles." In order to make a straddle-by-straddle identification election, the taxpayer must clearly identify each position that is part of the mixed straddle before the close (i.e., midnight, local time) of the day on which the straddle is established.[1] No election is permitted for any straddle composed of one or more positions that are included in a mixed straddle account (see discussion under "Mixed Straddle Accounts" in Q 7601), and no election is permitted if the taxpayer has made the election to exclude the IRC Section 1256 contract positions in the straddle from the mark-to-market tax rules. See Q 7599.[2]

If one or more positions included in a mixed straddle for which this election is made were held by the taxpayer on the day prior to the day the straddle was established, then such position (or positions) is deemed to have been sold for its fair market value as of the close of the last business day preceding the day the straddle was established; but an adjustment for any gain or loss recognized on such deemed sale will be made (through adjustment to basis or otherwise) to any subsequent gain or loss realized with respect to such position.[3]

Gains or losses from positions that are part of a mixed straddle for which a straddle-by-straddle identification election has been made are determined and treated according to the rules discussed in the following paragraphs. These rules apply prior to the application of the loss deferral and wash sale rules described in Q 7593.[4] The only portion of the tax straddle short sale rules that applies under these circumstances is that which provides that the holding period of any position that is part of the straddle is deemed not to begin before the date that the taxpayer no longer holds an offsetting position to that position.[5]

1. *All positions disposed of on the same day*. If all positions of the mixed straddle are disposed of on the same day, gains and losses from the IRC Section 1256 contracts in the straddle are netted. Gains and losses from non-IRC Section 1256 contract positions are also netted. Net gain or loss from the IRC Section 1256 contracts is then offset against the net gain or loss from non-IRC Section 1256 positions. If total net gain or loss from the straddle is attributable to IRC Section 1256 positions, then the capital gain or loss will be treated as 60 percent long-term and 40 percent short-term. If the total net gain or loss from the straddle is attributable to non-IRC Section 1256 positions, then the gain or loss will be *short-term* capital gain or loss.[6]

> *Example*: On March 1, Nathan enters into a non-IRC Section 1256 position and an offsetting IRC Section 1256 contract and makes a valid election to use the straddle-by-straddle identification rules. On March 10, Nathan disposes of the non-IRC Section 1256 position at a $600 loss and the IRC Section 1256 contract at a $800 gain. The total net gain of $200 on the straddle is attributable to the IRC Section 1256 position. Thus, 60 percent of the net gain ($120) will be long-term capital gain and 40 percent ($80) will be short-term capital gain.

1. Temp. Treas. Reg. §1.1092(b)-3T(d).
2. Temp. Treas. Reg. §1.1092(b)-3T(a).
3. Temp. Treas. Reg. §1.1092(b)-3T(b)(6).
4. Temp. Treas. Reg. §1.1092(b)-3T(c).
5. Temp. Treas. Regs. §§1.1092(b)-2T, 1.1092(b)-3T.
6. Temp. Treas. Reg. §1.1092-3T(b)(2).

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2. *All non-IRC Section 1256 positions disposed of on the same day*. If all of the non-IRC Section 1256 positions of the mixed straddle are disposed of on the same day, gains and losses realized from the non-IRC Section 1256 positions in the straddle are netted. Also, *realized and unrealized* gains and losses with respect to IRC Section 1256 contract positions are netted *as of that day* (see Q 7586). Net gain or loss realized from the non-IRC Section 1256 positions is then offset against the gain or loss from the IRC Section 1256 contracts. Any total net gain or loss from the straddle that is attributable to the non-IRC Section 1256 positions must be realized and treated as *short-term* capital gain or loss on that day. Any total net gain or loss that is attributable to *realized* gain or loss with respect to IRC Section 1256 positions must be realized and treated as 60 percent long-term and 40 percent short-term. Any gain or loss subsequently realized on the IRC Section 1256 contracts will be adjusted (through a basis adjustment or otherwise) to take into account the extent to which gain or loss was offset by unrealized gain or loss on the IRC Section 1256 contracts on that day.[1]

> *Example*: On June 20, Matthew enters into an IRC Section 1256 contract and an offsetting non-IRC Section 1256 position and makes a valid election to use the straddle-by-straddle identification rules. On June 27, Matthew realizes a $1,700 loss on the non-IRC Section 1256 position. As of June 27, there is $1,500 of unrealized gain in the IRC Section 1256 contract. On June 27, Matthew offsets the $1,700 loss on the non-IRC Section 1256 position against the $1,500 unrealized gain on the IRC Section 1256 contract. Because the resulting $200 loss on the straddle (realized on June 27th) is attributable to the non-IRC Section 1256 position, it is treated as a $200 *short-term* capital loss. Furthermore, assuming that Matthew still holds the IRC Section 1256 contract at year end, and assuming that there is $1,800 of unrealized gain in it at that time, then Matthew will also realize a gain of $300 ($1,800 minus $1,500 adjustment for unrealized gain offset against the non-IRC Section 1256 position in June) in that year because the IRC Section 1256 contract will be deemed to have been disposed of at year end (see Q 7586).

3. *All IRC Section 1256 positions disposed of on the same day*. If all of the IRC Section 1256 contract positions in the mixed straddle are disposed of (or deemed disposed of) on the same day, gains and losses realized on the IRC Section 1256 positions are netted. Also, realized *and unrealized* gains and losses with respect to non-IRC Section 1256 positions of the straddle are netted on that day. Net gain or loss realized from the IRC Section 1256 positions is then treated as *short-term* capital gain or loss to the extent of the net gain or loss on the non-IRC Section 1256 positions on the day. Net gain or loss with respect to the IRC Section 1256 positions that exceeds the net gain or loss on the non-IRC Section 1256 positions is treated as 60 percent long-term and 40 percent short-term.[2]

> *Example*: On December 30, Joshua enters into an IRC Section 1256 contract and an offsetting non-IRC Section 1256 position and makes a valid election to use the straddle-by-straddle identification rules. On December 31, Joshua disposes of the IRC Section 1256 contract at a gain of $1,500. As of December 31, there is $1,000 of unrealized loss in the non-IRC Section 1256 position. Under these circumstances, $1,000 of the gain realized on the IRC Section 1256 contract is short-term capital gain (i.e., to the extent of the unrealized loss on the non-IRC Section 1256 position). The other $500 of gain from the straddle is treated as 60 percent long-term capital gain ($300) and 40 percent short-term capital gain ($200).

1. Temp. Treas. Reg. §1.1092(b)-3T(b)(3).
2. Temp. Treas. Reg. §1.1092(b)-3T(b)(4).

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4. *Disposition of one or more, but not all, positions on the same day*. If one or more, but not all, of the positions of the mixed straddle are disposed of on the same day, but neither all IRC Section 1256 positions nor all non-IRC Section 1256 positions are disposed of on that day (i.e., neither (2) nor (3), above applies), then the straddle is taxed as follows: Gains and losses from the non-IRC Section 1256 positions that are disposed of on that day are netted. Gains and losses from the IRC Section 1256 positions that are disposed of on that day are netted. Then net gain or loss from the IRC Section 1256 positions disposed of is offset against the net gain or loss from the non-IRC Section 1256 positions disposed of. If the total net gain or loss from the dispositions on that day is attributable to the non-IRC Section 1256 positions disposed of, the rules described above in (2) are applied. If the total net gain or loss from the dispositions is attributable to the IRC Section 1256 positions disposed of, the rules described above in (3) are applied. If the net gain or loss from IRC Section 1256 positions disposed of and the net gain or loss from non-IRC Section 1256 positions disposed of are either both net gains or both net losses, then the rules described in (2) are applied to the net gain or loss from the non-IRC Section 1256 positions and the rules described in (3) are applied to the net gain or loss from the IRC Section 1256 positions. For purposes of taxing the gain or loss subsequently realized on another position in such straddle, to the extent that unrealized gain or loss on a position was used to offset realized gain or loss on a non-IRC Section 1256 position under (2) above, or resulted in the gain or loss on an IRC Section 1256 position being treated as short-term capital gain or loss under (3) above, such amount may not be used for such purpose again.[1]

> *Example*: On June 15, Allison enters into a straddle consisting of four non-IRC Section 1256 positions and four IRC Section 1256 contracts and makes a valid election to use the straddle-by-straddle identification rules. On June 20, Allison disposes of one non-IRC Section 1256 position at a gain of $800 and one IRC Section 1256 contract at a loss of $300. On the same day, there is $400 of unrealized net loss on the IRC Section 1256 contracts retained by Allison and $100 of unrealized net loss on the non-IRC Section 1256 positions retained by Allison. The loss of $300 on the IRC Section 1256 contract disposed of is offset against the gain of $800 on the non-IRC Section 1256 position disposed of. The resulting net gain of $500 is attributable to the non-IRC Section 1256 position. Therefore, the rules discussed above in (2) apply. Under those rules, the net loss of $700 ($300 + $400) on the IRC Section 1256 contracts is offset against the net gain of $800 attributable to the non-IRC Section 1256 position disposed of. As a result, the total net gain of $100 is treated as short-term capital gain (because it is attributable to the non-IRC Section 1256 position disposed of). Gain or loss subsequently realized on the IRC Section 1256 contracts will be adjusted to take into account the unrealized loss of $400 that was offset against the $800 gain attributable to the non-IRC Section 1256 position disposed of.

5. *Gain or loss from non-IRC Section 1256 positions after disposition of all IRC Section 1256 contracts*. If one or more non-IRC Section 1256 positions are held after all the IRC Section 1256 contract positions in the straddle have been disposed of, any gain or loss realized on those non-IRC Section 1256 positions will be *short-term* capital gain or loss to the extent that such gain or loss is attributable to the period when such positions were part of the straddle.[2] See Temporary Treasury Regulation Section 1.1092(b)-2T for the rules for determining the holding period with respect to such positions.

1. Temp. Treas. Reg. §1.1092(b)-3T(b)(5).
2. Temp. Treas. Reg. §1.1092(b)-3T(b)(7).

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7603. What is an "identified straddle"? How is it taxed?

An "identified straddle" is a straddle in which (1) all the original positions are acquired on the same day; (2) all positions are clearly identified in the investor's records as being part of an identified straddle before the close of that day (or other time prescribed by future regulations), including which positions are offsetting with respect to other positions in the straddle; (3) no position is part of a larger straddle; and (4) all positions remain open at the close of the year, or were closed out on the same day during the year.[1] Apparently, if a successor or substitute position replaces an original position of the straddle, the straddle ceases to be an identified straddle.[2]

In the case of an identified straddle, the loss deferral and wash sale rules discussed in Q 7593 do not apply. Instead, any loss realized with respect to a position in an identified straddle is treated as sustained no earlier than the day on which all positions making up the straddle are disposed of.[3]

The tax straddle short sale rules discussed in Q 7593 apply to identified straddles.[4]

While the IRC does not plainly set forth the application of the constructive sales rules of IRC Section 1259 to identified straddles, Congress' intent is, apparently, that a straddle designated as an identified tax straddle under IRC Section 1092(a)(2) will be treated as a constructive sale of an appreciated financial position under IRC Section 1259. This generally results in immediate gain recognition, the start of a new holding period, and an adjustment to basis (unless certain requirements are met for closing out the position constituting the constructive sale)[5] (see Q 7606 to Q 7608).

The Blue Book states that where either position in such an identified transaction is an appreciated financial position and a constructive sale of that position results from acquiring the second position, Congress intended that the constructive sale would be treated as having occurred immediately before the identified transaction. It adds that the constructive sale will not prevent qualification of the transaction as an identified straddle transaction. It is also the intent of Congress that future regulations will clarify the extent to which straddle transactions will be subject to or excepted from the constructive sale provisions.[6] Future regulations may clarify the manner in which these rules may be applied to identified straddles.

A portion of any gain recognized upon disposition or other termination of a straddle that is part of a *conversion transaction* (see Q 7604) may be treated as ordinary income. According to the IRC, these rules are applicable where substantially all of the taxpayer's expected return from the investment is attributable to the time value of the taxpayer's net investment in the transaction.[7] See Q 7604 and Q 7605 for the definition and tax treatment of conversion transactions.

1. IRC Sec. 1092(a)(2)(B).
2. See General Explanation – ERTA, p. 284.
3. IRC Sec. 1092(a)(2)(A).
4. See Temp. Treas. Reg. §1.1092(b)-2T.
5. General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), p. 176-177 (the 1997 Blue Book).
6. See 1997 Blue Book, p. 177.
7. IRC Sec. 1258(c).

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Note: Do not confuse "identified straddles," discussed above, with what the Temporary Regulations refer to as an "IRC Section 1092(b)(2) identified mixed straddle." The latter is discussed in Q 7602.

7604. What is a "conversion transaction"?

A "conversion transaction" is a transaction from which substantially all of the taxpayer's expected return is attributable to the time value of the taxpayer's net investment in the transaction, and that is (1) a transaction that encompasses an acquisition of any property and a substantially contemporaneous agreement to sell such property (or substantially identical property) at a price determined in accordance with the agreement; (2) an applicable straddle; (3) any transaction that is marketed or sold as producing capital gains from a transaction from which substantially all of the taxpayer's expected return is attributable to the time value of the net investment in the transaction; *or* (4) any transaction specified in future regulations.[1] In short, a conversion transaction is a financial arrangement that resembles a loan in an economic sense.

An "applicable straddle" means any straddle within the meaning of IRC Section 1092(c), except that the term "personal property" includes stock.[2]

The income tax consequences of conversion transactions are explained in Q 7605.

7605. How is a "conversion transaction" treated for income tax purposes?

In general, any gain that would otherwise be treated as gain from the sale or exchange of a capital asset and that is recognized on the disposition or other termination of any position held as part of a *conversion transaction* (see Q 7604) will be treated as ordinary income to the extent that such gain does not exceed an "applicable imputed income amount," as defined below.[3] The purpose of IRC Section 1258 is to prevent the use of conversion transactions to transform ordinary income into capital gain.

"Applicable imputed income amount" (for purposes of a disposition or termination of a conversion transaction) means the amount of interest that would have accrued on the taxpayer's net investment in the conversion transaction for the period ending on the date of such disposition (or on the date the transaction ceased to be a conversion transaction, if earlier) at a rate equal to 120 percent of the applicable rate (see below) reduced by any amounts previously treated as ordinary income under IRC Section 1258.[4] Future regulations will provide for reduction of the applicable imputed income amount for amounts capitalized under IRC Section 263(g). A taxpayer's net investment in a conversion transaction includes the fair market value of any position that becomes part of the transaction.[5]

The term "applicable rate" refers to the applicable federal rate as determined under IRC Section 1274(d) (compounded semiannually) as if the conversion transaction were a debt instrument,

1. IRC Sec. 1258(c).
2. IRC Sec. 1258(d)(1).
3. IRC Sec. 1258(a).
4. IRC Sec. 1258(b).
5. IRC Sec. 1258(d)(4).

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or, if the term of the conversion transaction is indefinite, the federal short-term rates in effect under IRC Section 6621(b) (relating to the determination of interest rates for overpayments and underpayments of tax) during the period of the conversion transaction (compounded daily).[1]

Regulations provide taxpayers with a method to net certain gains and losses from positions of the same conversion transaction before determining the amount of gain treated as ordinary income.[2] If a taxpayer disposes of or terminates all the positions of an "identified netting transaction" within a 14 day period in a single taxable year, all gains and losses on those positions realized within that period (other than built-in losses, see below) are netted solely for purposes of determining the amount of gain treated as ordinary income. An "identified netting transaction" is a conversion transaction that the taxpayer identifies as an identified netting transaction on its books and records. Identification of each position of the conversion transaction must be made before the close of the business day on which the position becomes part of the conversion transaction.[3]

A position with a "built-in" loss that becomes part of a conversion transaction is taken into account at its fair market value, determined as of the date the position becomes part of the conversion transaction; but upon disposition or other termination of the position (in a transaction in which gain or loss is realized), the built-in loss will be recognized and its character will be determined without regard to IRC Section 1258.[4] Thus, if a position with a built-in capital loss becomes part of a conversion transaction, upon a disposition of the position the built-in loss will retain its character as a capital loss for purposes of IRC Section 1258. "Built-in loss" means any loss that would have been realized if the position had been disposed of or otherwise terminated at its fair market value as of the time the position became a part of the conversion transaction.[5] A "built-in loss" can also arise if a taxpayer realizes a gain or loss on any one position of a conversion transaction and, as of the date that gain or loss is realized, there is unrealized loss in any other position of the conversion transaction that is not disposed of, terminated, or treated as sold under any provision of the IRC or regulations within 14 days of and within the same taxable year as the realization event.[6]

Although built-in loss is not recharacterized for purposes of IRC Section 1258, it appears that property with a built-in gain will not be afforded the same treatment. IRC Section 1258(a) states that *any* capital gain that is recognized on the disposition of a position held as part of a conversion transaction will be recharacterized as ordinary income to the extent the gain does not exceed the applicable imputed income amount. Thus, it seems that gain generated prior to property's inclusion in a conversion transaction is subject to recharacterization.

The conversion transaction rules do not apply to the transactions of an options or commodities dealer entered into in the normal course of business; but limited partners and certain

1. IRC Sec. 1258(d)(2).
2. Treas. Reg. §1.1258-1(a).
3. Treas. Reg. §1.1258-1(b).
4. IRC Sec. 1258(d)(3).
5. IRC Sec. 1258(d)(3)(B).
6. Treas. Reg. §1.1258-1(c).

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investors who have an interest in an enterprise other than as a limited partner will generally be subject to the conversion transaction rules.[1]

7606. What is an "appreciated financial position"?

IRC Section 1259 generally provides special treatment for "constructive sales of appreciated financial positions." Very generally, unless certain exceptions apply, such transactions result in a deemed sale with immediate recognition of gain (and a corresponding increase in basis in the property deemed sold), as well as the start of a new holding period (see Q 7608). The definition of "constructive sale" is explained in Q 7607.

For purposes of the constructive sales rules of IRC Section 1259, an *appreciated financial position* is any *position* with respect to any stock, debt instrument, or partnership interest if there would be a gain were the position sold, assigned, or otherwise terminated at its fair market value.[2] The term "position" is further defined as an interest, including a futures or forward contract (see Q 7582 to Q 7586), a short sale (see Q 7524 to Q 7533), or an option (see Q 7550 to Q 7575).[3] Furthermore, it was the intent of Congress that *offsetting notional principal contracts* (see Q 7608) also be included in the definition of "appreciated financial position," and such a definition is supported by the language of IRC Section 1259(c)(1)(D).[4]

An interest in a trust that is actively traded will be treated as stock, for purposes of determining whether it is an appreciated financial position, unless substantially all (by value) of the property held by the trust is debt that qualifies for the debt interest exception described below.[5]

Debt instrument exception. The term "appreciated financial position" does *not* include any position with respect to debt (e.g., bonds) if: (1) the *position* unconditionally entitles the holder to receive a specified principal amount; (2) the interest payments (or other similar amounts) with respect to such *position* are payable at a fixed rate or, to the extent provided in regulations, at a variable rate; and (3) such *position* is not convertible (directly or indirectly) into stock of the issuer or any *related person* (see Q 7607).[6] Furthermore, the term "appreciated financial position" does not include any *hedge* of a position satisfying all three of the foregoing requirements.[7]

Consequently, to qualify for the exception for a position with respect to debt instruments, the position *itself* would have to *either* meet the requirements as to unconditional principal amount, nonconvertibility, and interest terms *or*, alternatively, be a hedge of a position meeting these requirements. A hedge for purposes of this provision includes any position that reduces the taxpayer's risk of interest rate or price changes or currency fluctuations with respect to another position.[8]

1. IRC Sec. 1258(d)(5).
2. IRC Sec. 1259(b)(1).
3. IRC Sec. 1259(b)(3).
4. General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), p. 175 (the 1997 Blue Book).
5. IRC Sec. 1259(e)(2).
6. IRC Sec. 1259(b)(2)(A).
7. IRC Sec. 1259(b)(2)(B).
8. General Explanation of Tax Legislation Enacted in 1998 (JCS-6-98), p. 184 (the 1998 Blue Book).

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Mark to market exception. The term "appreciated financial position" does not include any position that is marked to the market (see Q 7586).[1]

7607. What constitutes a "constructive sale" of an appreciated financial position?

A taxpayer is generally treated as having made a constructive sale of an appreciated financial position (see Q 7606) if the taxpayer or a *related person* (1) enters into a short sale (see Q 7524) of the same or substantially identical property, (2) enters into an *offsetting notional principal contract* (defined below) with respect to the same or substantially identical property, or (3) enters into a futures contract (see Q 7582) or *forward contract* (defined below) to deliver the same or substantially identical property.[2]

In addition, if the appreciated financial position is a short sale, a futures contract (see Q 7582), a forward contract (see below), or an offsetting notional principal contract (see below), *with respect to any property*, a taxpayer who acquires the same or substantially identical property is generally treated as having made a constructive sale of the position.[3]

It appears that if a taxpayer holds a long-term position in actively traded stock (which is a capital asset in the taxpayer's hands) and enters into a securities futures contract to sell substantially identical stock at a time when the position in the stock has appreciated in value, the constructive sale rules will apply.[4]

The Secretary of the Treasury is authorized to issue regulations providing that certain other positions or transactions having substantially the same effect as those described above will also constitute a constructive sale.[5] The types of transactions intended to be targeted by such regulations are those that result in the reduction of both risk of loss and opportunity for gain; transactions that reduce only one or the other would not be affected.[6]

Nonpublicly traded property. A constructive sale does not include any contract for sale of any stock, debt instrument, or partnership interest that is not a *marketable security* if the contract settles within one year after the date the contract is entered into.[7] For this purpose, a *marketable security* means any security for which, as of the date of disposition, there was a market on an established securities market or otherwise.[8]

Closed Transactions

If a transaction that would otherwise be a constructive sale is closed within certain time limits, it will be disregarded. The IRC states that constructive sales treatment will not apply to any transaction that would otherwise be treated as a constructive sale during the taxable year if:

1. IRC Sec. 1259(b)(2)(C).
2. IRC Sec. 1259(c)(1)(A)-(C).
3. IRC Sec. 1259(c)(1)(D).
4. See H.R. Conf. Rep. No. 106-1033 (CRTRA 2000), "Straddle Rules," p. 1035.
5. IRC Sec. 1259(c)(1)(E).
6. See General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), p. 177 (the 1997 Blue Book).
7. IRC Sec. 1259(c)(2).
8. IRC Secs. 1259(c)(2), 453(f).

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(1) the transaction is closed before the end of the 30th day after the close of the taxable year (i.e., the "extended taxable year");

(2) the taxpayer holds the appreciated financial position throughout the 60-day period beginning on the date the transaction is closed; *and*

(3) at no time during the 60-day period is the taxpayer's risk of loss with respect to the position reduced by reason of holding an option to sell, an obligation to sell, or a short sale, being the grantor of a call option, or certain other transactions diminishing the risk of loss.[1]

A closed transaction that is, in essence, reestablished (or replaced with a substantially similar transaction) before the 60-day period described above elapses, then closed again within the extended taxable year, may also be disregarded. The Internal Revenue Code states that if:

(a) a transaction, which would otherwise be treated as a constructive sale of an appreciated financial position, is closed during the taxable year or during the 30 days thereafter (the extended taxable year), *and*

(b) another substantially similar transaction is entered into during the 60-day period beginning on the date that the original transaction is closed, that (i) also would otherwise be treated as a constructive sale of the position, and (ii) is closed before the end of the extended taxable year in which the original transaction occurs, and the transaction meets requirements (2) and (3), above,

then the substantially similar transaction will be disregarded for purposes of determining whether the original transaction met requirement (3) above (relating to the reduction of the taxpayer's risk of loss during the 60-day period following the closed transaction).[2]

Constructive Sales of Multiple Appreciated Financial Positions

The IRC states that if there is a constructive sale of any appreciated financial position, such position is subsequently disposed of, and at the time of the disposition, the transaction resulting in the constructive sale of the position is still open with respect to the taxpayer or any related person (defined below), then solely for purposes of determining whether the taxpayer has entered into a constructive sale of any other appreciated financial position, the taxpayer will be treated as entering into the transaction immediately after the disposition. For purposes of this rule, an assignment or other termination will be treated as a disposition.[3]

The Blue Book explains the preceding paragraph (and provides an example) as follows: "A transaction that has resulted in a constructive sale of an appreciated financial position (e.g., a short sale) is not treated as resulting in a constructive sale of *another* appreciated financial position

1. See IRC Secs. 1259(c)(3), 246(c)(4).
2. IRC Sec. 1259(c)(3)(B).
3. IRC Sec. 1259(e)(1).

as long as the taxpayer holds the position that was treated as constructively sold. But when that position is assigned, terminated or disposed of by the taxpayer, the taxpayer immediately thereafter is treated as entering into the transaction that resulted in the constructive sale (e.g., the short sale) if it remains open at that time. Thus, the transaction can cause a constructive sale of another appreciated financial position at any time thereafter."[1]

> *Example*: Assume a taxpayer holds two appreciated stock positions and one offsetting short sale, and the taxpayer identifies the short sale as offsetting one of the stock positions. If the taxpayer then sells the stock position that was identified, the identified short position would cause a constructive sale of the taxpayer's other stock position at that time.[2]

The IRC also provides that if a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if so, which appreciated financial position is deemed sold will be made in the same manner as actual sales.[3]

Identified Pre-TRA '97 Positions

Under Section 1001(d)(2) of the Taxpayer Relief Act of 1997, if a taxpayer entered into a transaction that was a constructive sale of any appreciated financial position before June 9, 1997, and so identified the offsetting positions to the IRS by August 5, 1997, the rules of IRC Section 1259 shall not apply to determine whether a constructive sale occurred.

Where a taxpayer with identified pre-TRA '97 offsetting positions transferred the short position from the original broker to a second broker, the grandfather provision continued to apply.[4]

Definitions

A *forward contract* is a contract to deliver a substantially fixed amount of property, including cash, for a substantially fixed price.[5] The definition of a forward contract includes a contract that provides for cash settlement with respect to a substantially fixed amount of property at a substantially fixed price.[6] According to the Blue Book, a forward contract results in a constructive sale *only* if it provides for delivery, or for cash settlement, of a substantially fixed amount of property and a substantially fixed price. If the amount of property provided for by the forward contract is subject to significant variation under the terms of the contract, it will not constitute a forward contract.[7] Furthermore, an agreement that is not a "contract" for purposes of applicable contract law or that is subject to "very substantial contingencies" was not intended to be treated as a forward contract.[8]

1. 1997 Blue Book, pp. 174-175 (emphasis added).
2. 1997 Blue Book, p. 175.
3. IRC Sec. 1259(e)(3).
4. Rev. Rul. 2004-15, 2004-1 CB 515.
5. IRC Sec. 1259(d)(1).
6. General Explanation of Tax Legislation Enacted in 1998 (JCS-6-98), p. 185 (the 1998 Blue Book).
7. See Rev. Rul. 2003-7, 2003-1 CB 363.
8. 1997 Blue Book, p. 176.

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But the Service distinguished a case in which in addition to entering into a forward contract pledging to deliver property that was the same as or substantially identical to an appreciated financial position that he held, a taxpayer loaned and delivered the shares to the other party at the time of the contract. In that case, the IRS found a constructive sale.[1]

The Service has ruled that a currency forward contract in which the amount ultimately received would be determined by both intervening currency fluctuations and market interest rates was in fact a debt instrument for tax purposes.[2]

The Service had requested comments in 2008 on the tax treatment of *prepaid forward contracts* in which the purchase price is paid in advance of future delivery or cash settlement.[3] The IRS was considering whether the parties to such contracts should be required to accrue any income or expense during the term of the transaction. That project was sidetracked, at least temporarily, however, by the debt crisis.

The term *offsetting notional principal contract* means, with respect to any property, an agreement that includes (1) a requirement to pay (or provide credit for) all or substantially all of the investment yield (including appreciation) on such property for a specified period and (2) a right to be reimbursed for (or receive credit for) all or substantially all of any decline in the value of such property.[4] (A "swap" is one type of offsetting notional principal contract).

For purposes of the constructive sales rules, a person is *related* to another person with respect to a transaction if (a) the relationship is described in IRC Section 267(b) (which includes persons related by family as well as related entities) or IRC Section 707(b) (related partnerships) (see Q 607 for details of both definitions), *and* (b) the transaction is entered into with a view toward avoiding the purposes of the constructive sales rules.[5]

"Substantially identical stock or securities" is not defined in IRC Section 1259. Under earlier law, the meaning of the term as used for purposes of the short sale rules is the same as that used for the wash sale rules (see Q 7528, Q 7536). It would seem logical that the same definition would be used for purposes of constructive sales of appreciated financial positions.

Note: Do not confuse a "constructive sale of an appreciated financial position" with a "constructive ownership transaction" (see Q 7609 and Q 7610). The former applies to certain hedging positions held by a taxpayer and results in deemed sale treatment and immediate recognition of gain. The latter applies to a taxpayer's purchase of a derivative whose investment return is tied to the performance of a pass-through entity, instead of purchasing a direct interest in the pass-through entity itself, and results in the conversion of long-term capital gain into ordinary income. In other words, the former represents a deemed sale and the latter represents deemed (i.e., constructive) ownership.

1. TAM 200604033.
2. Rev. Rul. 2008-1, 2008-1 CB 248.
3. Notice 2008-2, 2008-1 CB 252.
4. IRC Sec. 1259(d)(2).
5. IRC Sec. 1259(c)(4).

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7608. How is a constructive sale of an appreciated financial position treated for tax purposes?

If there is a constructive sale of an appreciated financial position, the taxpayer generally recognizes *gain* as if the position were sold, assigned, or otherwise terminated at its fair market value on the date of the constructive sale (and any gain is taken into account for the taxable year that includes the date of the constructive sale).[1]

For purposes of the tax treatment of the position after a constructive sale has been taxed under IRC Section 1259, the IRC states that "proper adjustment shall be made in the amount of any gain or loss subsequently realized with respect to such position for any gain taken into account" under the constructive sale treatment described above.[2] Since constructive sale treatment by definition applies only to *appreciated* financial positions, this provision should have the effect of increasing the taxpayer's basis for purposes of any future disposition.[3]

The taxpayer must also begin a new holding period, as if the appreciated financial position were originally acquired on the date of the constructive sale.[4] But except as provided in future regulations, a constructive sale generally is not treated as a sale for other IRC purposes.[5]

Part of the complexity of IRC Section 1259 treatment lies in the fact that some positions constitute an appreciated financial position, some transactions result in a constructive sale, and some (depending on the taxpayer's other holdings) can do either. For example, a short sale can constitute either an appreciated financial position *or* a constructive sale, depending on the taxpayer's other holdings. The same is true of certain futures or forward contracts and offsetting notional principal contracts.[6]

Under the plain wording of IRC Section 1259, the holding of an option constitutes an appreciated financial position, but *not* a constructive sale.[7] But as authorized by IRC Section 1259(c)(1)(E), future regulations may clarify the definition of "constructive sale" to include certain combinations of options.[8] Furthermore, under the rules of IRC Section 1233 governing short sales, the acquisition of a put option is treated as a short sale; obviously, such an application in the context of IRC Section 1259 would have broad consequences.

According to the Blue Book, Congress's intent was to treat any transaction that reduces *both* the risk of loss *and* the opportunity for gain as a constructive sale. Thus, for example, the holding of a stock position and the purchase of an at-the-money put option would not constitute a constructive sale since the option reduces only the taxpayer's risk of loss, not his opportunity for gain.[9] Future regulations should clarify the interaction of IRC Section 1259 and the treatment of options.

1. IRC Sec. 1259(a)(1).
2. IRC Sec. 1259(a)(2)(A).
3. See also, General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), p. 174 (the 1997 Blue Book).
4. IRC Sec. 1259(a)(2)(B).
5. 1997 Blue Book, pp. 173-174.
6. See IRC Secs. 1259(b)(3), 1259(c)(1).
7. See IRC Secs. 1259(b)(3), 1259(c).
8. 1997 Blue Book, pp. 177-178.
9. See 1997 Blue Book, p. 177.

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7609. What is a "constructive ownership transaction"?

IRC Section 1260 generally provides special treatment for "constructive ownership transactions" occurring after July 11, 1999.[1] In general, IRC Section 1260 targets the use of certain derivative contracts by taxpayers in arrangements that are primarily designed to convert what otherwise would be ordinary income and short-term capital gain into long-term capital gain. Congress was particularly concerned about derivative contracts with respect to partnerships and other pass-through entities. The use of such contracts would otherwise result in the taxpayer's being taxed in a more favorable manner than if the taxpayer had actually acquired an ownership interest in the pass-through entity (i.e., being taxed at favorable capital gains rates, rather than at the applicable marginal rate for ordinary income).[2]

Generally, a taxpayer is treated as having entered into a *constructive ownership transaction* with respect to any *financial asset* if the taxpayer:

(1) holds a *long position under a notional principal contract* (defined below) with respect to the financial asset;

(2) enters into a *forward contract* (defined below) or futures contract (see Q 7582) to acquire the financial asset;

(3) is the holder of a call option and the grantor (i.e., writer) of a put option (see Q 7555) on a financial asset, and the options have substantially equal strike prices and substantially contemporaneous maturity dates; or

(4) to the extent provided in future regulations, enters into one or more other transactions (or acquires one or more positions) that have substantially the same effect as those described above.[3]

The types of transactions intended to be targeted by the regulations are those that replicate the economic benefits of direct ownership of a financial asset without a significant change in the risk-reward profile with respect to the underlying transaction.[4] The Secretary may also issue regulations that permit taxpayers to mark constructive ownership transactions to the market instead of applying these rules, and to exclude certain forward contracts that do not convey substantially all of the economic return with respect to a financial asset.[5]

Mark to market exception. A constructive ownership transaction will not be subject to these rules if all of the positions are marked to the market (see Q 7586).[6]

For the tax treatment of gain from a constructive ownership transaction, see Q 7610.

One example of a conversion transaction involving a derivative contract is set forth in the Senate Report for TREA '99. The transaction involves an arrangement between a taxpayer and a

1. TREA '99, Secs. 534(a), 534(c).
2. S. Rep. No. 106-201 (TREA '99).
3. IRC Sec. 1260(d)(1).
4. S. Rep. No. 106-201 (TREA '99).
5. IRC Sec. 1260(g).
6. IRC Sec. 1260(d)(2).

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securities dealer whereby the dealer agrees to pay the taxpayer any appreciation with respect to a notional investment in a hedge fund. In return, the taxpayer agrees to pay the securities dealer any depreciation in the value of the notional investment. The arrangement lasts for more than one year. The taxpayer is in substantially the same economic position as if he or she owned the interest in the hedge fund directly, yet the taxpayer may treat any appreciation resulting from the contractual arrangement as long-term capital gain. Moreover, any tax attributable to such gain is deferred until the arrangement is terminated.[1]

Definitions

Financial asset means any equity interest in any pass-through entity and, to the extent provided in regulations, any debt instrument and any stock in a corporation that is not a pass-through entity.[2]

Pass-through entity is defined to include: (1) a regulated investment company (i.e., mutual fund) (see Q 7850); (2) a real estate investment trust (REIT) (see Q 7883); (3) an S corporation (see Q 7736); (4) a partnership (see Q 7692 to Q 7694); (5) a trust (see Q 7665 to Q 7666); (6) a common trust fund; (7) a passive foreign investment company; (8) a foreign personal holding company; (9) a foreign investment company; and (10) a REMIC (see Q 7673 and Q 7674).[3]

A taxpayer will be treated as holding a *long position under a notional principal contract* with respect to any financial asset if the taxpayer has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on that financial asset for a specified period, *and* is obligated to reimburse (or provide credit for) all or substantially all of any decline in the value of that financial asset.[4]

The term *forward contract* means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.[5]

Note: Do not confuse a "constructive sale of an appreciated financial position" (see Q 7606 to Q 7608) with a "constructive ownership transaction." The former applies to certain hedging positions held by a taxpayer and results in deemed sale treatment and immediate recognition of gain. The latter applies to a taxpayer's purchase of a derivative contract whose investment return is tied to the performance of a pass-through entity, instead of purchasing a direct interest in the pass-through entity, and results in the conversion of long-term capital gain into ordinary income. In other words, the former represents a deemed sale, and the latter represents deemed (i.e., constructive) ownership.

7610. How is a "constructive ownership transaction" treated for tax purposes?

If a taxpayer has gain from a "constructive ownership transaction" (see Q 7609) with respect to any "financial asset" (see Q 7609) and that gain would ordinarily be treated as a long-term

1. S. Rep. No. 106-201 (TREA '99).
2. IRC Sec. 1260(c)(1).
3. IRC Sec. 1260(c)(2).
4. IRC Sec. 1260(d)(3).
5. IRC Sec. 1260(d)(4).

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capital gain, such gain will instead be treated as ordinary income to the extent that the gain exceeds the *net underlying long-term capital gain*.[1]

For purposes of the constructive ownership transaction rules, *net underlying long-term capital gain* means the aggregate net capital gain that the taxpayer would have had if (1) the financial asset had been acquired for fair market value on the date the transaction was opened and sold for fair market value on the date the transaction was closed; *and* (2) only gains and losses that would have resulted from the deemed ownership under (1) were taken into account. If the taxpayer does not establish the amount of the net underlying long-term capital gain with respect to any financial asset by clear and convincing evidence, the amount of such gain will be treated as zero.[2]

If any gain is treated as ordinary income for any taxable year on account of these rules, the tax imposed for that year is increased by imposing interest at the underpayment rate for every prior tax year in which any portion of the constructive ownership transaction was open.[3] The calculation of the interest is explained in IRC Section 1260(b)(2). No credits are allowed against the increase in tax.[4]

To the extent that gain is treated as long-term capital gain after the application of IRC Section 1260(a)(1) (i.e., instead of being recharacterized as ordinary income), it will be subject to the capital gain tax in the same manner as is the net underlying long-term capital gain.[5] See Q 608 for the treatment of capital gains and losses.

Special rule where taxpayer takes delivery. Generally, if a constructive ownership transaction is closed by reason of taking delivery, the constructive ownership rules will be applied as if the taxpayer had sold all the contracts, options, or other positions that are part of the transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence will not exceed the amount of gain treated as ordinary income under IRC Section 1260(a). The IRC states that proper adjustments will be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this special rule.[6]

The intended effect of IRC Section 1260 is to limit the amount of long-term capital gain a taxpayer can recognize from derivative transactions with respect to certain pass-through entities. The amount that may be treated as long-term capital gain is limited to the amount of such gain the taxpayer would have had if the taxpayer owned a direct interest in the pass-through entity during the term of the derivative contract. Any gain in excess of this amount is treated as ordinary income. In addition, an interest charge is imposed on the amount of gain that is treated as ordinary income. The provision does not alter the amount of gain that is not treated as ordinary income.[7]

1. IRC Sec. 1260(a).
2. IRC Sec. 1260(e).
3. See IRC Sec. 1260(b)(1).
4. IRC Sec. 1260(b)(4).
5. IRC Sec. 1260(a)(2).
6. IRC Sec. 1260(f).
7. Joint Committee on Taxation, *Summary of Conference Agreement on H.R. 1180 Relating to Expiring Tax Provisions and Other Revenue Provisions* (JCX-85-99).

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