**8592. How does an offsetting short position impact a taxpayer’s eligibility to exclude 50% of the gain on the sale of qualified small business stock?**

Under IRC Section 1202, if a taxpayer has an *offsetting short position* with respect to any qualified small business stock, the otherwise applicable 50% exclusion (see Q 8591) is unavailable unless:

(a) the stock was held for more than five years as of the date of entering into the short position; *and*

(b) the taxpayer elects to recognize gain as if the stock were sold at its fair market value on the first day the offsetting position was held.[[1]](#footnote-1)

A taxpayer has an “offsetting short position” with respect to any qualified small business stock if the taxpayer (or a related party) has (a) made a short sale of substantially identical property, (b) acquired an option to sell substantially identical property at a fixed price, or (c) to the extent expected to be provided in future regulations, entered into any other transaction that substantially reduces the taxpayer’s risk of loss from holding the qualified small business stock.[[2]](#footnote-2)

Taxpayers should note that certain offsetting short positions (e.g., a short sale) may also result in constructive sale treatment under the rules of IRC Section 1259. While the IRC does not specifically address the impact of IRC Section 1259 on IRC Section 1202, it would appear that if the requirements of IRC Section 1202(j) are otherwise met, the exclusion provided under IRC Section 1202 would not be lost merely because the taxpayer may be required to immediately recognize gain under IRC Section 1259.

1. . IRC Sec. 1202(j)(1). [↑](#footnote-ref-1)
2. . IRC Sec. 1202(j)(2). [↑](#footnote-ref-2)