Congress of the United States
JOINT COMMITTEE ON TAXATION
1015 LONGWORTH HOUSE OFFICE BUILDING
Washington, D.C. 20515

JCX-18-81

TAX STRADDLE MATERIAL DISTRIBUTED DURING WAYS AND MEANS MARKUP ON JULY 10, 1981

Description of Revised Proposal on Straddles by Mr. Brodhead

Present law

Commodity futures contracts are treated as capital assets with special six-month holding period. Gain or loss is recognized upon disposition of a contract. Proper treatment of losses on partial disposition of straddle positions is disputed. Internal Revenue Service has denied deduction on certain partial dispositions as tax-motivated and incomplete transactions in Revenue Ruling 77-185.

Explanation of provision

Futures contracts would be marked-to-market at year end, or upon disposition if earlier, and taxed as if 50 percent were long-term capital gains or losses, and 50 percent were short-term. Net mark-to-market losses would be deductible against other capital gains in year of loss.

A three-year carryback would be provided for mark-to-market losses.

Losses on other straddle would be recognized after gain leg is held at-risk 30 days, or after the disposition of the entire straddle, if earlier.

Interest and carrying charges on a commodity held as part of a straddle would be added to the basis of the commodity.

Hedging transactions would be exempt from mark-to-market, loss deferral and cash and carry rules.

Treasury bills would be treated as capital assets.

Dealer would be required to designate securities held as investment on date of acquisition.

A taxable disposition of a capital asset would be treated as a sale or exchange of a capital asset, resulting in capital gain or loss.

Effective date

The bill generally would apply to property acquired after January 27, 1981.

However, dealer designation of securities and identification requirements would apply prospectively.

Revenue effect

The bill would increase budget receipts by $1.4 billion in fiscal year 1982.

Amendment to Revised Brodhead Proposal
to be offered by Mr. Russo

Substitute for the rules on mark-to-market, loss deferral, and cash and carry, the following:

I. Disallowance of certain losses.

Losses from commodity-related transactions would be disallowed to the extent such losses exceed gains from transactions in commodity-related property.

Commodity-related property includes:
futures contracts,
actual commodities, including metals,
Treasury bills,
other debt instruments
interests in Treasury bills and debt instruments,
forward contracts, and
currency.

Commodity-related property does not include gains on real estate, publicly-traded stock, nor interest income from Treasury bills and other debt instruments. However, dealers in securities may treat interest income as gain from commodity-related property.

Excess losses may be carried forward.

Anti-conversion rule. Losses from commodity-related transactions would be treated as long-term capital losses to the extent of the lesser of (A) the amount by which such allowable losses exceed net short-term gains from transactions in commodity-related property, or (B) the amount by which the net long-term gains from such transactions exceed losses such allowable losses which are long-term capital losses.

Exemption. Hedging transactions which are conducted in the normal course of a trade or business and which produce ordinary income or loss are exempt from the loss disallowance and the anti-conversion rules. [There is also a hedging exemption to cash and carry.]

II. Cash and Carry

Interest and carrying charges for a commodity held as part of a straddle would be added to the basis of the commodity except in the case of traders, who could deduct such interest and carrying charges from their gains in transactions in commodity-related property.

A trader would be defined as a person whose principal trade or business and whose principal source of income is trading commodity futures contracts.

7/9/81

Prepared by the Staff of the Joint Committee on Taxation, July 10, 1981

General Comparison of Major Provisions of Straddles Proposals

Provision	Revised Brodhead	Administration	Finance Committee	Russo
I. Straddles in Futures Contracts	Mark-to-market for all futures Gains: 50% long, 50% short Any ordinary items at regular rates.	Small traders: regular treatment of capital gains and losses. Others: Mark-to-market at ordinary rates.	Same as Brodhead Gains: 60% long, 40% short Same as Brodhead	No Mark-to Market.
II. Other Straddles	Straddles losses allowed after gain leg held at risk 30 days, or entire straddle is closed if earlier. Holding period for balanced positions	Same as Brodhead	(Similar to Brodhead)	Commodity--related losses deductible only to extent of commodity-related gains.
III. Cash and Carry Straddles	Add interest and carrying charges to basis of commodity held as part of straddle.	Same as Brodhead	Same as Brodhead	Same as Brodhead, except futures traders may deduct interest and carrying charges from commodity related gains.
IV. Exemptions	Ordinary income hedging transactions of trade or business exempt from I, II, and III.	Same as Brodhead	Same as Brodhead	Same as Brodhead, but from II and III.
V. Treasury Bills	Treated as capital assets	Same as Brodhead	Same as Brodhead	Same as Brodhead.
VI. Dealer Designation of Investment Securities	Date of acquisition	Same as Brodhead	Same as Brodhead	Same as Brodhead.
VII. Sale or Exchange	Taxable dispositions of capital assets treated as sale or exchange.	Same as Brodhead	Same as Brodhead	Same as Brodhead.
VIII. Off-Exchange Transactions	Addition substantiation required for non-business transactions outside U.S,	—	—	Same as Brodhead.
IX. Transition Relief	Taxpayer may elect mark-to-market for futures held on effective date.	Same as Brodhead	Same as Brodhead	—
X. Effective Date	Generally, January 26, 1981.		Generally, June 24, 1981	Same as Brodhead.

BRODHEAD AMENDMENT

I. LOSSES FROM STRADDLES

(a) General Rule: When a loss is incurred as a result of liquidating the loss contract(s) in a straddle, it cannot be recognized until the remaining contracts in the straddle have been held in an unbalanced position for 30 days. The loss can be recognized immediately, however, when the investor also liquidates the remaining contract(s) in the straddle (that is, he realizes his offsetting gains).

This rule does not apply to straddles which are marked to the market or which are hedges. (See Mark-to-the-Market System (II), and Exceptions (IV), below).

(b) Covered Property: This loss deferral rule would apply to interests in commodities, evidences of indebtedness, currency and any other type of personal property which is not marked-to-market under II, below.

(c) Excluded Property: The loss deferral rule would not apply to real property; publicly-traded stock, except for stock in corporations substantially all of whose assets constitute interests in commodities; nor to exchange-traded stock options which cannot produce long-term capital gains.

II. MARK-TO-MARKET SYSTEM FOR FUTURES CONTRACTS

(a) Mark-to-Market for Futures Contracts: All gains and losses on regulated futures contracts would be determined under the mark-to-market, daily cash-flow system used by futures exchanges for setting margin requirements. A taxpayer's tax liability would be determined by totaling his gains and losses on the futures contracts he holds on December 31 (year end), and by taking into account any gain or loss on the disposition of regulated futures contracts earlier in the year. (An exception would be provided for inventory and certain other hedges. See IV, below.)

(b) Tax Rate: Capital gains and losses on futures contracts would be treated as if 50 percent of the gains and losses were short-term and 50 percent were long-term.

(c) Capital Loss Carryback: Net capital losses on futures contracts could be carried back three-years against prior year mark-to-market gains on futures contracts.

(d) Mixed Straddles: Taxpayers could designate mixed straddles (futures contracts balanced against other property) and include such straddles in the mark-to-market system. Otherwise, the general loss deferral rule (I, above) would apply.

III. CASH AND CARRY TRANSACTIONS

(a) Deductible Expenses: Taxpayers could continue to deduct interest and carrying charges paid or incurred for commodities held as part of a straddle, provided the commodity is an ordinary income property involved in an inventory or business hedge.

(b) Capital Items: Interest and carrying charges, which are paid or incurred to hold a commodity comprising part of a straddle and which are not deductible under III(a), must be added to the basis of the commodity. This will reduce or eliminate the amount of capital gains tax owed at the time the commodity is sold. (See Exceptions, IV, below.)

IV. EXCEPTION: HEDGING

(a) Exception: Property belonging to ordinary income hedging transactions, which are so designated and which are executed in the normal course of trade or business, would not be subject to the mark-to-market, loss deferral, and capitalization rules.

(b) Retention of Present Accounting Rules: Taxpayers would continue to use present law tax accounting procedures for reporting income and loss in transactions falling within the hedging exception. However, as under present law, procedures resulting in a distortion of income could be challenged.

V. TREASURY BILLS: CAPITAL ASSETS

(a) Characterization: Government discount obligations (Treasury bills) would be treated as capital assets.

(b) Market Discount: In determining how much of the appreciation on a Treasury bill is interest (ordinary income) and how much is capital gain, the market discount on the bill would be treated as interest.

VI. DEALER DESIGNATION OF SECURITIES

Dealers would be required to designate securities held as investments (and therefore eligible for capital gain and loss treatment) on the date of acquisition.

VII. SALE OR EXCHANGE

All taxable dispositions of capital assets would be treated as sales or exchanges, thus producing capital gains or losses. (Nontaxable dispositions, such as gifts, would not be affected.)

VIII. SUBSTANTIATION REQUIREMENTS FOR OFF-EXCHANGE POSITIONS

In order to deduct losses which result from transactions not conducted on domestic exchanges or domestic boards of trade (for example, transactions in foreign markets), the taxpayer must substantiate the execution of the transaction and must make available probative records and information.

IX. TRANSITIONAL RULE

Gains deferred from prior years into 1981 through futures contracts held on the effective date could be placed on the mark-to-market system with its special rates.