

the allocation based on relative market values required by Revenue Ruling 65-31 must be used."

This "rule of thumb" seems to be an acceptable solution to the first problem.

The second of the problems which have arisen as a result of the ruling does not seem susceptible to an administrative resolution. This stems from the fact that the writer of a straddle normally receives different kinds of income or loss from his writing of straddles.

To illustrate these various types of income or loss assume first that the market rises after the straddle is written and that the "call" is exercised. If the straddle writer purchases stock to cover the "call" at the time of exercise, he will then suffer a loss to the extent the market price (and his cost for the stock) exceeds the call price. This loss is reduced (or possibly eliminated), however, by the straddle premium. That part of the premium allocated to the "call" is treated as an additional receipt from the sale of the called stock. Thus, this income is taken into account in determining the loss on the called stock. The result, in this case, may well be a short-term loss. However, the portion of the premium resulting from the lapsed option, is ordinary income under the 1954 Code.²⁴ Thus, the straddle writer could have ordinary income and capital loss resulting from the writing of one straddle.

The same result would obtain if the market fell and the "put" was exercised. If the market price falls more than the premium allocable to the "put", then the writer of the straddle who is required to purchase stock at the price of the market when the straddle was written, would be holding stock with a "built-in" capital loss. If he sells the stock and thereby realizes this loss, in this case also he would have both a capital loss and ordinary income arising from the writing of one straddle.

Apart from the \$1,000 per year deduction against income for capital losses (sec. 1211(b) of the code), the capital loss could not be used to offset ordinary income. Thus, even though the straddle writer may suffer a net economic loss, he may nevertheless be required to pay taxes on ordinary income derived from the straddle transaction.

²⁴ As indicated above, it would have been short-term capital gain under the 1939 Code, and so could have been netted against the other two types of straddle income.