

PART FOUR—POSSIBLE SOLUTION

It would appear that, in general, what originates as one transaction should result in either a single taxable consequence or a set of taxable consequences that may be netted against each other if some of those consequences are profits and some are losses. Accordingly, the staff explored the possibility of identifying the profits and losses attributable to the writing of any one straddle. It was hoped that a method could be provided for setting off such profits and losses against each other. It soon became apparent that difficulties would arise in determining the portion of gain or loss attributable to a straddle in the event of the exercise of one component of the straddle. Difficulties would arise in determining the price of a stock at the moment the option was exercised; extensive records would have to be kept; and a new category of income would be added to the existing categories of ordinary income, long-term capital gains, short-term capital gains, and section 1231 income.

On the other hand, it was concluded that an approach which modified the treatment of only the income resulting from lapse of an option would present few of these difficulties. Much of the desired netting effect could be accomplished by treating all the types of receipts from the writing of straddles (premium income from lapsed options, premium income from exercised options, and gain or loss from the purchase or sale of securities at other than the current market price) as ordinary income or as capital gains or losses. The capital gains or losses alternative appears preferable because (1) it has long been accepted that purchase and sale of securities by one who does not hold securities for sale to customers in the ordinary course of his trade or business are capital transactions; (2) it is similarly accepted that premium income from exercised options result in adjustments to capital asset transactions; (3) a change in these rules with respect to the gain or loss attributable to the straddle element that is exercised (even if otherwise desirable) would result in substantial problems in distinguishing, in the gain or loss from a sale or purchase, between the straddle elements and the nonstraddle capital elements; (4) purchasers of options are treated as sustaining capital losses when they permit options to expire (sec. 1234, I.R.C. 1954); and (5) the 1939 Code (sec. 117(g)(2)) provided for capital gain treatment of option lapse income.

The joint committee staff concluded that the problem described above could probably best be dealt with by providing that income derived from the lapse of an option written as a part of a straddle is to be taxed as a short-term capital gain. Insofar as straddles are concerned, this is similar to the treatment provided in section 117(g)(2) of the 1939 Code.

This treatment achieves the primary purpose of permitting the netting of different kinds of income or losses arising from a straddle, since short-term capital gains are first offset against short-term capital losses and, to the extent of any excess still remaining, are next offset against net long-term capital losses. Thus, should the portion of the straddle premium allocated to the part of the straddle exercised give