

rise to either short- or long-term capital losses, there will be an opportunity for netting against this loss any income obtained from the side of the straddle allowed to lapse. In addition, treating the premium income attributable to the lapse as a short-term capital gain will still mean that after netting against capital losses—either short-term or long-term—any excess gain still remaining will be treated in the same manner as ordinary income since this is the treatment uniformly accorded any such excess of short-term capital gains over capital losses. This, therefore, while generally providing for the netting with respect to the two sides of the straddle, still maintains the position of the Internal Revenue Service (as reflected in its ruling) that income from the lapse of a portion of a straddle option represents ordinary income.

By comparison with the practice prior to January 1965, this suggestion (combined with allocation of premiums between the components of straddles) would result in some shifting from long-term capital gain to short-term capital gain and in earlier recognition (and therefore earlier subjection to tax) of option-lapse income. By comparison with the rules in effect since January 1965, this proposal would result in some earlier effective recognition of capital losses and their use to offset option-lapse income otherwise taxable at ordinary rates.

The proposed treatment of straddle option lapse income as short-term capital gains would not apply to dealers—i.e., persons who hold securities for sale to customers in the ordinary course of their trades or businesses.

Since the problem that gave rise to the study—a single transaction resulting in ordinary income which cannot be netted against a possible capital loss from the same straddle—does not arise in the case of the writing of separate options to buy or sell, it is suggested that any such change be limited to income from the lapse of options that originate as parts of straddles.

The problem which gave rise to this study centered about straddles in issued stocks. However, such option devices are occasionally used in bonds and, perhaps, convertible debentures, when issued stocks, warrants, and similar securities. The same considerations would seem to apply in the case of such property and it is believed that the proposed treatment of straddle option lapse income probably should apply to securities generally.

It is not clear whether the term “securities” includes commodities futures.²⁵ Since we have received no suggestion that Rev. Rul. 65-31 has created any problems regarding commodities futures, no need is seen for applying proposed change to options on contracts to buy such items.

Since Rev. Rul. 65-31 applies only to transactions entered into after January 25, 1965, and since the staff study of the problems arising out of the ruling began at about that time, it is suggested that any legislation along the lines suggested probably should apply to straddles written after January 25, 1965. This will minimize the number of changes in applicable law.

²⁵ There appears to be a conflict on this point within the context of the “wash sales” provisions of section 1091 of the 1954 Code, the successor to section 118 of the 1939 Code. Compare *Trenton Cotton Oil Co. v. Commissioner*, 147 F. 2d 33, 36-37, 33 AFTR 610 (C.C.A. 6, 1945), holding that commodities futures are securities for these purposes, with *Corn Products Refining Co. v. Commissioner*, 215 F. 2d 513, 516-517, 46 AFTR 528 (C.A. 2, 1954), affirmed on another point, 350 U.S. 46 (1955), holding that they are not.