

APPENDIX

APPENDIX I—REVENUE RULING 65-31*

For immediate release, Friday, January 22, 1965.

TIR-683

The U.S. Internal Revenue Service today announced that the following revenue ruling relating to the treatment of premiums received by taxpayers who write "straddle" options will appear in Internal Revenue Bulletin No. 1965-9, dated March 1, 1965:

Rev. Rul. 65-31

Since a "straddle" contains two options (a "put" option and a "call" option) each of value, it is necessary to allocate the premium received by the writer thereof to each option. The allocation of the premium should be made on the basis of the relative market value of the "put" and "call" options contained therein, at the time of the issuance of the "straddle." A portion of the premium received by the writer for the option contained in the "straddle" that was exercised is to be taken into account in determining gain or loss on that transaction, while the portion of the premium which is attributable to the expired option will be treated as ordinary income.

The Internal Revenue Service has been requested to state its position with respect to the treatment for Federal income tax purposes of premiums received by a taxpayer who writes "straddle" options where only one of the options contained therein is exercised.

A "straddle" is a combination of a "put" and a "call" option on the same stock or commodity, both options describing the same quantity at the same price that the stock or commodity may be "called" from or "put" to the writer thereof.

A "put" is an option to sell certain property, usually stock or commodities, to the writer thereof at a designated price within a designated time. If a "put" is exercised, the premium the writer has received decreases his basis in the property purchased ("put" to him) from the optionee. (See Rev. Rul. 58-234, C.B. 1958-1, 279.)

A "call" is an option to buy certain property, usually stock or commodities, from the writer thereof at a designated price within a designated time. If a "call" is exercised, the premium the writer has received for writing the "call" is added to the amount realized on sale of the "called" property to the optionee. (See Rev. Rul. 58-234.)

If the optionee permits a "put" or a "call" to expire without exercise, the premium the writer has received for the privilege of keeping an obligation open is considered ordinary income (Sec. 1.1234-1(b) of the Income Tax Regulations).

The question presented is whether the premium received by the writer of a "straddle" should be allocated by him wholly to the exercised option under circumstances where one option is exercised and the other is not. If the correct rule were that it should be allocated wholly to the exercised option and, for example, the optionee exercised only the "put," the entire premium received for writing the "straddle" would reduce the writer's cost basis in the property "put" to him. Conversely, if the "call" were the only option exercised, the premium received for writing the "straddle" would be added to the amount realized on the property "called" from him.

However, a "straddle," although commonly referred to as one contract embodying both a "put" and a "call," is, in fact, two separate option contracts. Each, neither, or both may be sold or exercised, by the same or different persons. The holder of a "put" or a "call" written pursuant to a "straddle" contract has rights and liabilities no greater or less than he would have had if a "put" and "call" were purchased separately but simultaneously on the same terms. A "straddle" contract, accordingly, contains two separately identifiable options. See *Bertha Silverman v. Alfons Landa et al.*, 200 Fed. Supp. 193 (1961), affirmed,

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