

[October 11, 1966]

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INCOME TAX TREATMENT OF CERTAIN STRADDLE TRANSACTIONS

Mr. MILLS. Mr. Speaker, I ask unanimous consent that the Committee of the Whole House on the State of the Union be discharged from further consideration of the bill H.R. 11765 to amend section 1234 of the Internal Revenue Code of 1954, which was reported to the House unanimously by the Committee on Ways and Means, and ask for its immediate consideration.

The Clerk read the title of the bill.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

Mr. CURTIS. Mr. Speaker, reserving the right to object, and I shall not, I should like to ask the chairman of the committee to explain briefly the bill.

Mr. MILLS. Mr. Speaker, will the gentleman yield?

Mr. CURTIS. I yield to the gentleman from Arkansas.

Mr. MILLS. Mr. Speaker, this bill, H.R. 11765, is intended to permit the netting of gains and losses resulting from the granting of certain types of options to buy and sell corporate stock.

The transactions I have referred to in stock market parlance are known as "straddles." Briefly, a straddle is a combination of an option to buy and an option to sell the same quantity of a security at the same price during the same period of time. The option to buy is known as a "call." The option to sell is known as a "put." Typically, the combination—the straddle—is written by a person who owns the stock and does not believe that it is likely to fluctuate in value very much over the long run. The inducement to write the straddle is the receipt of a premium for it. A straddle is sold by the writer to a dealer, who then normally separates out the component options and sells the put—the option to sell to the writer—to one investor and the call—the option to purchase from the writer—to another investor. Normally, if the market in that security moves upward, the call is exercised and the put option is allowed to lapse. If the market in that security moves downward, then the put is apt to be exercised and the call allowed to lapse. Sometimes—generally about 10 to 15 percent of the time—the movement in the stock is so slight that neither option holder exercises his option. Rarely—less than 1 percent of the time—the stock fluctuates so much that both component options are exercised. This bill is intended to have its primary effect in the overwhelming majority of the cases—where one component option is exercised and the other is not.

Under the 1939 Internal Revenue Code and under the 1954 code until January

1965, it was the usual practice for the writer of a straddle to treat the entire premium as either an increase in the amount received for the stock when the call was exercised, or as a decrease in the writer's cost of the stock when the put was exercised. As a result, the premium merely increased a capital gain or decreased a capital loss.

Under a ruling issued in January in 1965, the Internal Revenue Service has been requiring the writer of a straddle to apportion his premium between the put option and the call option. That part of the premium allocated to the option that ultimately is exercised would continue, as in the past, to either increase the writer's capital gain or decrease his capital loss. The part of the premium allocated to the option that ultimately lapses is treated as ordinary income. Consequently, a single straddle transaction now might well result in the writer realizing both ordinary income and a capital loss. Since net capital losses can be used to offset ordinary income only to the extent of \$1,000 a year, a writer's straddles transactions may well result in both ordinary income and capital losses which could not be netted against each other.

Straddles are viewed by those who write them as giving rise to a single transaction. This seems to be borne out by the facts in these cases, for example, the premium received by the writer of the straddle is less than the premium received by the writer of an option to buy plus a completely separate option to sell. Also, the stock exchange company that endorses the option—guarantees that it will be honored if it is exercised—will require considerably less collateral from the writer of a straddle than it will from the writer of a separate option to buy and a separate option to sell.

Because of this combination of characteristics, the Ways and Means Committee concluded that some method ought to be found to permit the gains and losses resulting from the straddle transactions to be netted against each other.

This bill permits just such netting by treating the option lapse income in these cases as short-term capital gains. Since all the gains and losses from a straddle would be capital gains and losses, they could be netted against each other. However, any net profits would normally result in short-term capital gains, and would be taxed generally as ordinary income.

The problem giving rise to this bill was examined by the staff of the Joint Committee on Internal Revenue Taxation at the request of former Senator Harry F. Byrd and myself, in our capacities as vice chairman and chairman last year of the joint committee. The requested study was announced in a