

to the transaction described in clause (i) of this subparagraph,

(II) which is closed on or before the 30th day after the close of the taxable year in which the transaction referred to in clause (i) occurs, and

(III) which meets the requirements of clauses (ii) and (iii) of subparagraph (A),

the transaction referred to in clause (ii) shall be disregarded for purposes of determining whether the requirements of subparagraph (A)(iii) are met with respect to the transaction described in clause (i).

(4) Related person

A person is related to another person with respect to a transaction if—

(A) the relationship is described in section 267(b) or 707(b), and

(B) such transaction is entered into with a view toward avoiding the purposes of this section.

(d) Other definitions

For purposes of this section—

(1) Forward contract

The term “forward contract” means a contract to deliver a substantially fixed amount of property (including cash) for a substantially fixed price.

(2) Offsetting notional principal contract

The term “offsetting notional principal contract” means, with respect to any property, an agreement which includes—

(A) a requirement to pay (or provide credit for) all or substantially all of the investment yield (including appreciation) on such property for a specified period, and

(B) a right to be reimbursed for (or receive credit for) all or substantially all of any decline in the value of such property.

(e) Special rules

(1) Treatment of subsequent sale of position which was deemed sold

If—

(A) there is a constructive sale of any appreciated financial position,

(B) such position is subsequently disposed of, and

(C) at the time of such disposition, the transaction resulting in the constructive sale of such position is open with respect to the taxpayer or any related person,

solely for purposes of determining whether the taxpayer has entered into a constructive sale of any other appreciated financial position held by the taxpayer, the taxpayer shall be treated as entering into such transaction immediately after such disposition. For purposes of the preceding sentence, an assignment or other termination shall be treated as a disposition.

(2) Certain trust instruments treated as stock

For purposes of this section, an interest in a trust which is actively traded (within the meaning of section 1092(d)(1)) shall be treated as stock unless substantially all (by value) of the property held by the trust is debt described in subsection (b)(2)(A).

(3) Multiple positions in property

If a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if so, which appreciated financial position is deemed sold shall be made in the same manner as actual sales.

(f) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

(Added Pub. L. 105-34, title X, §1001(a), Aug. 5, 1997, 111 Stat. 903; amended Pub. L. 105-206, title VI, §6010(a)(1), (2), July 22, 1998, 112 Stat. 812, 813; Pub. L. 108-311, title IV, §406(e), Oct. 4, 2004, 118 Stat. 1189.)

AMENDMENTS

2004—Subsec. (c)(2). Pub. L. 108-311, §406(e)(1), substituted “A taxpayer shall not be treated as having made a constructive sale solely because the taxpayer enters into a contract” for “The term ‘constructive sale’ shall not include any contract”.

Subsec. (c)(3)(A). Pub. L. 108-311, §406(e)(2), substituted “cause a constructive sale” for “be treated as a constructive sale” in introductory provisions.

Subsec. (c)(3)(A)(i). Pub. L. 108-311, §406(e)(3), substituted “on or before” for “before the end of”.

Subsec. (c)(3)(B). Pub. L. 108-311, §406(e)(7), substituted “certain closed transactions where risk of loss on appreciated financial position diminished” for “positions which are reestablished” in heading.

Subsec. (c)(3)(B)(i). Pub. L. 108-311, §406(e)(2), substituted “cause a constructive sale” for “be treated as a constructive sale”.

Subsec. (c)(3)(B)(ii). Pub. L. 108-311, §406(e)(4), struck out “substantially similar” after “another” in introductory provisions.

Subsec. (c)(3)(B)(ii)(I). Pub. L. 108-311, §406(e)(5), amended subcl. (I) generally. Prior to amendment, subcl. (I) read as follows: “which also would otherwise be treated as a constructive sale of such position.”

Subsec. (c)(3)(B)(ii)(II). Pub. L. 108-311, §406(e)(6), inserted “on or” before “before the 30th day”.

1998—Subsec. (b)(2)(A)(i) to (iii). Pub. L. 105-206, §6010(a)(1)(A), substituted “position” for “debt”.

Subsec. (b)(2)(B), (C). Pub. L. 105-206, §6010(a)(1)(B), (C), added subpar. (B) and redesignated former subpar. (B) as (C).

Subsec. (d)(1). Pub. L. 105-206, §6010(a)(2), inserted “(including cash)” after “property”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-311 effective as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 406(h) of Pub. L. 108-311, set out as a note under section 55 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to any constructive sale after June 8, 1997, with certain exceptions, see section 1001(d) of Pub. L. 105-34, set out as an Effective Date of 1997 Amendment note under section 475 of this title.

§ 1260. Gains from constructive ownership transactions

(a) In general

If the taxpayer has gain from a constructive ownership transaction with respect to any finan-

cial asset and such gain would (without regard to this section) be treated as a long-term capital gain—

(1) such gain shall be treated as ordinary income to the extent that such gain exceeds the net underlying long-term capital gain, and

(2) to the extent such gain is treated as a long-term capital gain after the application of paragraph (1), the determination of the capital gain rate (or rates) applicable to such gain under section 1(h) shall be determined on the basis of the respective rate (or rates) that would have been applicable to the net underlying long-term capital gain.

(b) Interest charge on deferral of gain recognition

(1) In general

If any gain is treated as ordinary income for any taxable year by reason of subsection (a)(1), the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under paragraph (2) with respect to each prior taxable year during any portion of which the constructive ownership transaction was open. Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

(2) Amount of interest

The amount of interest determined under this paragraph with respect to a prior taxable year is the amount of interest which would have been imposed under section 6601 on the underpayment of tax for such year which would have resulted if the gain (which is treated as ordinary income by reason of subsection (a)(1)) had been included in gross income in the taxable years in which it accrued (determined by treating the income as accruing at a constant rate equal to the applicable Federal rate as in effect on the day the transaction closed). The period during which such interest shall accrue shall end on the due date (without extensions) for the return of tax imposed by this chapter for the taxable year in which such transaction closed.

(3) Applicable Federal rate

For purposes of paragraph (2), the applicable Federal rate is the applicable Federal rate determined under section 1274(d) (compounded semiannually) which would apply to a debt instrument with a term equal to the period the transaction was open.

(4) No credits against increase in tax

Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining—

(A) the amount of any credit allowable under this chapter, or

(B) the amount of the tax imposed by section 55.

(c) Financial asset

For purposes of this section—

(1) In general

The term “financial asset” means—

(A) any equity interest in any pass-thru entity, and

(B) to the extent provided in regulations—
(i) any debt instrument, and
(ii) any stock in a corporation which is not a pass-thru entity.

(2) Pass-thru entity

For purposes of paragraph (1), the term “pass-thru entity” means—

(A) a regulated investment company,

(B) a real estate investment trust,

(C) an S corporation,

(D) a partnership,

(E) a trust,

(F) a common trust fund,

(G) a passive foreign investment company (as defined in section 1297 without regard to subsection (d) thereof), and

(H) a REMIC.

(d) Constructive ownership transaction

For purposes of this section—

(1) In general

The taxpayer shall be treated as having entered into a constructive ownership transaction with respect to any financial asset if the taxpayer—

(A) holds a long position under a notional principal contract with respect to the financial asset,

(B) enters into a forward or futures contract to acquire the financial asset,

(C) is the holder of a call option, and is the grantor of a put option, with respect to the financial asset and such options have substantially equal strike prices and substantially contemporaneous maturity dates, or

(D) to the extent provided in regulations prescribed by the Secretary, enters into one or more other transactions (or acquires one or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

(2) Exception for positions which are marked to market

This section shall not apply to any constructive ownership transaction if all of the positions which are part of such transaction are marked to market under any provision of this title or the regulations thereunder.

(3) Long position under notional principal contract

A person shall be treated as holding a long position under a notional principal contract with respect to any financial asset if such person—

(A) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on such financial asset for a specified period, and

(B) is obligated to reimburse (or provide credit for) all or substantially all of any decline in the value of such financial asset.

(4) Forward contract

The term “forward contract” means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

(e) Net underlying long-term capital gain

For purposes of this section, in the case of any constructive ownership transaction with respect

to any financial asset, the term “net underlying long-term capital gain” means the aggregate net capital gain that the taxpayer would have had if—

(1) the financial asset had been acquired for fair market value on the date such transaction was opened and sold for fair market value on the date such transaction was closed, and

(2) only gains and losses that would have resulted from the deemed ownership under paragraph (1) were taken into account.

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

(f) Special rule where taxpayer takes delivery

Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and

(2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset.

(Added Pub. L. 106-170, title V, §534(a), Dec. 17, 1999, 113 Stat. 1931; amended Pub. L. 108-357, title IV, §413(c)(23), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 110-172, §11(a)(23), (24)(B), Dec. 29, 2007, 121 Stat. 2486.)

AMENDMENTS

2007—Subsec. (c)(2)(G). Pub. L. 110-172 substituted “subsection (d)” for “subsection (e)” and inserted “and” at end.

2004—Subsec. (c)(2)(H) to (J). Pub. L. 108-357 redesignated subpar. (J) as (H) and struck out former subpars. (H) and (I), which included foreign personal holding company and foreign investment company (as defined in section 1246(b)) within definition of “pass-thru entity”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE

Pub. L. 106-170, title V, §534(c), Dec. 17, 1999, 113 Stat. 1934, provided that: “The amendments made by this

section [enacting this section] shall apply to transactions entered into after July 11, 1999.”

PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

Subpart

- A. Original issue discount.
- B. Market discount on bonds.
- C. Discount on short-term obligations.
- D. Miscellaneous provisions.

AMENDMENTS

1986—Pub. L. 99-514, title XVIII, §1899A(72), Oct. 22, 1986, 100 Stat. 2963, inserted “on bonds” after “discount” in item for subpart B.

SUBPART A—ORIGINAL ISSUE DISCOUNT

Sec.

- 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments.
- 1272. Current inclusion in income of original issue discount.
- 1273. Determination of amount of original issue discount.
- 1274. Determination of issue price in the case of certain debt instruments issued for property.
- 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.
- 1275. Other definitions and special rules.

AMENDMENTS

1985—Pub. L. 99-121, title I, §102(d), Oct. 11, 1985, 99 Stat. 509, added item 1274A.

§ 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments

(a) General rule

For purposes of this title—

(1) Retirement

Amounts received by the holder on retirement of any debt instrument shall be considered as amounts received in exchange therefor.

(2) Ordinary income on sale or exchange where intention to call before maturity

(A) In general

If at the time of original issue there was an intention to call a debt instrument before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to—

(i) the original issue discount, reduced by

(ii) the portion of original issue discount previously includible in the gross income of any holder (without regard to subsection (a)(7) or (b)(4) of section 1272 (or the corresponding provisions of prior law)),

shall be treated as ordinary income.

(B) Exceptions

This paragraph (and paragraph (2) of subsection (c)) shall not apply to—

- (i) any tax-exempt obligation, or
- (ii) any holder who has purchased the debt instrument at a premium.

(3) Certain short-term Government obligations

(A) In general

On the sale or exchange of any short-term Government obligation, any gain realized