

119TH CONGRESS
2D SESSION

S. _____

To amend the Internal Revenue Code of 1986 to modernize the tax treatment of derivatives and their underlying investments, and for other purposes.

IN THE SENATE OF THE UNITED STATES

Mr. WYDEN introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to modernize the tax treatment of derivatives and their underlying investments, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Modernization of Derivatives Tax Act of 2026”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-
2 sion of the Internal Revenue Code of 1986.

3 **SEC. 2. MODERNIZATION OF TAX TREATMENT OF CERTAIN**
4 **DERIVATIVES.**

5 (a) IN GENERAL.—Subchapter E of chapter 1 is
6 amended by adding at the end the following new part:

7 **“PART IV—TAX TREATMENT OF DERIVATIVES**
8 **AND SIMILAR CONTRACTS**

“SUBPART A. DERIVATIVES

“SUBPART B. SIMILAR CONTRACTS

9 **“Subpart A—Derivatives**

“Sec. 491. Rules for treatment of derivatives.

“Sec. 492. Investment hedging units.

“Sec. 493. Derivative defined.

10 **“SEC. 491. RULES FOR TREATMENT OF DERIVATIVES.**

11 “(a) IN GENERAL.—For purposes of this title, if
12 there is a taxable event with respect to a derivative or an
13 underlying investment—

14 “(1) notwithstanding any other provision of this
15 title, except as provided in subsection (b)(3)(A) or
16 section 1032, gain or loss shall be recognized and
17 taken into account in the taxable year in which the
18 taxable event occurs, and

19 “(2) proper adjustment shall be made in the
20 amount of any subsequent gain or loss for gain or
21 loss taken into account by reason of paragraph (1).

1 “(b) RULES RELATING TO GAIN OR LOSS.—Notwith-
2 standing any other provision of this title—

3 “(1) CHARACTER AND SOURCE OF GAIN OR
4 LOSS.—

5 “(A) CHARACTER.—Except as provided in
6 paragraph (3)(A), any item of income, deduc-
7 tion, gain, or loss taken into account under sub-
8 section (a) with respect to a taxable event shall
9 be treated as—

10 “(i) ordinary income or loss, and

11 “(ii) attributable to a trade or busi-
12 ness of the taxpayer for purposes of sec-
13 tions 62(a) and 172(d)(4).

14 “(B) SOURCE OF GAIN OR LOSS FROM DE-
15 RIVATIVES.—In the case of a taxable event with
16 respect to a derivative, any item of income, de-
17 duction, gain, or loss taken into account under
18 subsection (a) shall be treated as derived from
19 sources within the country of residence, incor-
20 poration, or organization of the taxpayer.

21 “(2) DETERMINATION OF AMOUNT.—

22 “(A) IN GENERAL.—The amount of gain
23 or loss taken into account under subsection (a)
24 with respect to a taxable event shall be—

1 “(i) in the case of a taxable event in-
2 volving the termination or transfer of a de-
3 rivative or the sale or exchange of an un-
4 derlying investment, the amount of gain or
5 loss determined under this title with re-
6 spect to the taxable event, or

7 “(ii) in the case of any other taxable
8 event, the amount of gain or loss which
9 would be determined under this title if, im-
10 mediately before the taxable event—

11 “(I) in the case of a derivative,
12 the derivative were terminated or
13 transferred at its fair market value, or

14 “(II) in the case of an underlying
15 investment, the investment were sold
16 or exchanged at its fair market value.

17 “(B) RELIANCE ON VALUATION.—For pur-
18 poses of subparagraph (A), the taxpayer may
19 rely on a valuation which is—

20 “(i) provided to the taxpayer by a
21 broker under section 6045(b), or

22 “(ii) determined under an applicable
23 financial statement.

24 “(3) SPECIAL RULES FOR TAXABLE EVENTS
25 WITH RESPECT TO INVESTMENT HEDGING UNITS.—

1 “(A) IN GENERAL.—In the case of a tax-
2 able event described in subsection (c)(2) with
3 respect to a derivative or underlying investment
4 (other than a termination or transfer of the de-
5 rivative or the sale or exchange of the under-
6 lying investment)—

7 “(i) notwithstanding subsection (a),
8 built-in loss (if any) with respect to the de-
9 rivative or underlying investment shall not
10 be recognized and shall not be taken into
11 account by reason of such taxable event,
12 and

13 “(ii) notwithstanding paragraph (1),
14 built-in gain (if any) with respect to the
15 underlying investment shall be treated as
16 long-term or short-term capital gain if the
17 built-in gain would have been so treated if
18 the investment were sold or exchanged at
19 its fair market value immediately before
20 the time that the built-in gain is deter-
21 mined under subparagraph (D).

22 “(B) IDENTIFICATION.—For purposes of
23 this paragraph, the determination of which por-
24 tions of an underlying investment have been
25 deemed sold or exchanged in a taxable event

1 shall be made in the same manner as if there
2 had been an actual sale or exchange.

3 “(C) BUILT-IN LOSS.—For purposes of
4 this section, the term ‘built-in loss’ means, with
5 respect to any derivative or underlying invest-
6 ment in an investment hedging unit, any loss
7 which would have been recognized and taken
8 into account under subsection (a) if the deriva-
9 tive were terminated or transferred, or the un-
10 derlying investment were sold or exchanged, at
11 its fair market value as of the later of the time
12 that the investment hedging unit was estab-
13 lished or the time that the derivative or the un-
14 derlying investment became part of the invest-
15 ment hedging unit.

16 “(D) BUILT-IN GAIN.—For purposes of
17 this section, the term ‘built-in gain’ means, with
18 respect to any underlying investment in an in-
19 vestment hedging unit, any gain which would
20 have been recognized and taken into account
21 under subsection (a) if the underlying invest-
22 ment were sold or exchanged at its fair market
23 value as of the later of the time that the invest-
24 ment hedging unit was established or the time

1 that the underlying investment became part of
2 the investment hedging unit.

3 “(4) SPECIAL TRANSITION RULES FOR REITS
4 ELECTING TO INCLUDE CERTAIN DEBT INSTRU-
5 MENTS IN HEDGING UNITS.—If a taxpayer makes
6 the election under section 492(b)(4) with respect to
7 an investment hedging unit, then, in applying this
8 subsection to such unit, the following rules shall
9 apply:

10 “(A) BUILT-IN GAINS AND LOSSES.—Para-
11 graph (3) shall be applied by—

12 “(i) including in built-in loss under
13 subparagraph (C) the excess (determined
14 as of the effective date of the election) of
15 built-in loss of the underlying investment
16 or the derivatives over the built-in gain of
17 the derivatives or the underlying invest-
18 ment, and

19 “(ii) including in built-in gain under
20 subparagraph (D) the excess (as so deter-
21 mined) of built-in gain of the underlying
22 investment or the derivatives over the
23 built-in loss of the derivatives or the un-
24 derlying investment.

1 “(B) CAPITAL LOSS CARRYOVERS.—If, for
2 any taxable year during which such election is
3 in effect with respect to such investment hedg-
4 ing unit, a taxpayer has a capital loss carryover
5 to such taxable year from any taxable year pre-
6 ceding such taxable year, the taxpayer shall, in
7 addition to other short-term capital gain of the
8 taxpayer (if any), treat as short-term capital
9 gain (rather than as ordinary income) an
10 amount equal to the lesser of—

11 “(i) the net gain from such invest-
12 ment hedging unit (as determined under
13 section 491(a)) during such taxable year ,
14 or

15 “(ii) the sum of—

16 “(I) any built-in loss with respect
17 to such investment hedging unit sus-
18 pended under section 491(b)(3) and
19 recognized as a result of a taxable
20 sale or exchange during the taxable
21 year, plus

22 “(II) the capital loss carryovers
23 to such taxable year from any such
24 preceding taxable year.

1 “(c) TAXABLE EVENT.—For purposes of this part,
2 the term ‘taxable event’ means—

3 “(1) with respect to any derivative which is not
4 part of an investment hedging unit—

5 “(A) the termination or transfer of such
6 derivative, and

7 “(B) the close of any taxable year if the
8 taxpayer has rights or obligations with respect
9 to such derivative at such time, and

10 “(2) with respect to all derivatives and under-
11 lying investments which are part of the same invest-
12 ment hedging unit—

13 “(A) the establishment of the investment
14 hedging unit,

15 “(B) the termination or transfer of any
16 such derivative,

17 “(C) the sale or exchange of all or any por-
18 tion of any such underlying investment,

19 “(D) the entering into of another deriva-
20 tive, or the acquisition of an additional amount
21 of such underlying investment, after the estab-
22 lishment of the investment hedging unit if such
23 derivative or additional amount is treated as
24 part of the investment hedging unit under sec-
25 tion 492, and

1 “(E) in the case of—

2 “(i) an investment hedging unit with
3 respect to which an election is in effect
4 under section 492(b), the close of each
5 business day, and

6 “(ii) any other investment hedging
7 unit, the close of any taxable year if the
8 applicable hedging period with respect to
9 such unit includes such close.

10 “(3) TERMINATION OR TRANSFER.—For pur-
11 poses of this part, the term ‘termination or transfer’
12 includes, with respect to any derivative, any termi-
13 nation or transfer by offsetting, by taking or making
14 delivery, by exercise or being exercised, by assign-
15 ment or being assigned, by lapse, by sale or other
16 disposition, by assumption, or otherwise.

17 “(d) TREATMENT OF PAYMENTS WITH RESPECT TO
18 CERTAIN DERIVATIVES.—Notwithstanding any other pro-
19 vision of this title—

20 “(1) IN GENERAL.—Except as provided by the
21 Secretary, in the case of a payment pursuant to a
22 derivative (other than an option)—

23 “(A) any item of income, deduction, gain,
24 or loss with respect to the payment shall be

1 taken into account for purposes of this title at
2 the time of the payment, and

3 “(B) proper adjustment shall be made in
4 the amount of any subsequent gain or loss for
5 items taken into account by reason of subpara-
6 graph (A).

7 This paragraph shall not apply to a payment in con-
8 nection with a taxable event.

9 “(2) RULES RELATING TO CHARACTER AND
10 SOURCE OF GAIN OR LOSS.—In the case of any item
11 of income, deduction, gain, or loss with respect to
12 payments described in paragraph (1)—

13 “(A) the rules of subsection (b)(1)(A) shall
14 apply in determining the character of such
15 item, and

16 “(B) except as provided in section 871(m),
17 the rule of subsection (b)(1)(B) shall apply in
18 determining the source of such item.

19 “(e) SUSPENSION OF HOLDING PERIOD WHILE UN-
20 DERLYING INVESTMENT PART OF INVESTMENT HEDGING
21 UNIT.—For purposes of section 1222, in the case of any
22 underlying investment which is part of an investment
23 hedging unit, the holding period for such investment shall
24 not include any period during which the underlying invest-
25 ment is part of such unit.

1 “(f) APPLICABLE FINANCIAL STATEMENT.—For
2 purposes of this part, the term ‘applicable financial state-
3 ment’ means—

4 “(1) an applicable financial statement (as de-
5 fined in section 451(b)(3)),

6 “(2) a financial statement which is made on the
7 basis of international financial reporting standards
8 and is filed by the taxpayer with an agency of a for-
9 eign government which is equivalent to the United
10 States Securities and Exchange Commission and
11 which has reporting standards not less stringent
12 than the standards required by such Commission,
13 but only if there is no statement of the taxpayer de-
14 scribed in paragraph (1), or

15 “(3) a financial statement filed by the taxpayer
16 with any other regulatory or governmental body
17 specified by the Secretary, but only if there is no
18 statement of the taxpayer described in paragraph
19 (1) or (2).

20 **“SEC. 492. INVESTMENT HEDGING UNITS.**

21 “(a) INVESTMENT HEDGING UNIT.—For purposes of
22 this part—

23 “(1) IN GENERAL.—Except as provided in sub-
24 section (b)—

1 “(A) a taxpayer shall be treated as having
2 an investment hedging unit with respect to an
3 underlying investment during any applicable
4 hedging period with respect to the underlying
5 investment, and

6 “(B) subject to paragraph (3), such invest-
7 ment hedging unit shall at any time during the
8 applicable hedging period consist of the fol-
9 lowing held by the taxpayer at such time:

10 “(i) Each derivative with respect to
11 the underlying investment which has a
12 delta with respect to any portion of the un-
13 derlying investment which is within the
14 range beginning with minus 0.7 and end-
15 ing with minus 1.0.

16 “(ii) Each portion of the underlying
17 investment described in clause (i) with re-
18 spect to which any derivative has a delta
19 within the range described in clause (i).

20 “(2) APPLICABLE HEDGING PERIOD.—The term
21 ‘applicable hedging period’ means, with respect to
22 any underlying investment of a taxpayer, a contin-
23 uous period—

24 “(A) beginning with the first time (after a
25 period which is not an applicable hedging pe-

1 riod) the taxpayer holds 1 or more of the de-
2 rivatives with respect to the underlying invest-
3 ment, and 1 or more portions of the underlying
4 investment, which are described in paragraph
5 (1)(B), and

6 “(B) ending with the time none of such de-
7 rivatives and portions are so described.

8 “(3) SPECIAL RULES RELATING TO DELTA AND
9 COMBINING DERIVATIVES.—

10 “(A) IN GENERAL.—For purposes of this
11 subsection—

12 “(i) a derivative with respect to an
13 underlying investment shall be treated as
14 having a delta within the range described
15 in paragraph (1)(B)(i) if the derivative by
16 itself, or in combination with 1 or more
17 other derivatives, has such delta with re-
18 spect to any portion of such underlying in-
19 vestment, and

20 “(ii) the determination under para-
21 graph (1)(B) of which derivatives have
22 such delta, and each portion of the under-
23 lying investment with respect to which
24 such derivatives have such delta, shall be
25 made in the manner which results in the

1 largest portion of such underlying invest-
2 ment being so described.

3 “(B) SECRETARIAL AUTHORITY FOR AP-
4 PPLICABLE TRADED DERIVATIVES.—The Sec-
5 retary may prescribe regulations or other guid-
6 ance to modify the rules under subparagraph
7 (A) to simplify the application of such rules to
8 applicable traded derivatives.

9 “(4) APPLICABLE TRADED DERIVATIVES.—For
10 purposes of paragraph (3)—

11 “(A) IN GENERAL.—The term ‘applicable
12 traded derivative’ means any listed option or
13 regulated futures contract.

14 “(B) REGULATED FUTURES CONTRACT.—
15 The term ‘regulated futures contract’ means a
16 contract—

17 “(i) with respect to which the amount
18 required to be deposited and the amount
19 which may be withdrawn depends on a sys-
20 tem of marking to market, and

21 “(ii) which is traded on (or subject to
22 the rules of) a qualified board or exchange.

23 “(C) LISTED OPTION.—The term ‘listed
24 option’ means any option (other than a right to
25 acquire stock from the issuer) which is traded

1 on (or subject to the rules of) a qualified board
2 or exchange.

3 “(D) QUALIFIED BOARD OR EXCHANGE.—

4 The term ‘qualified board or exchange’
5 means—

6 “(i) a national securities exchange
7 which is registered with the Securities and
8 Exchange Commission,

9 “(ii) a domestic board of trade des-
10 ignated as a contract market by the Com-
11 modity Futures Trading Commission, or

12 “(iii) any other exchange, board of
13 trade, or other market which the Secretary
14 determines has rules adequate to carry out
15 the purposes of this part.

16 “(b) ELECTION WITH RESPECT TO ITEMS INCLUDED
17 IN INVESTMENT HEDGING UNIT.—

18 “(1) IN GENERAL.—For purposes of this part,
19 a taxpayer may elect to treat all derivatives with re-
20 spect to an underlying investment, and all of such
21 underlying investment, as part of an investment
22 hedging unit.

23 “(2) ELECTION.—Any election under this sub-
24 section with respect to an underlying investment—

1 “(A) shall apply to all derivatives with re-
2 spect to such underlying investment, and all of
3 such underlying investment, held at any time
4 after the election is made (including during any
5 period such derivatives or underlying invest-
6 ment are not held simultaneously), and

7 “(B) shall be irrevocable.

8 “(3) DEEMED ELECTION FOR TAXPAYERS FAIL-
9 ING TO IDENTIFY.—

10 “(A) IN GENERAL.—If a taxpayer—

11 “(i) does not have an election in effect
12 under paragraph (1) with respect to an un-
13 derlying investment, and

14 “(ii) fails to meet the requirements of
15 subsection (c) for testing and identifying
16 derivatives with respect to the underlying
17 investment,

18 the taxpayer shall be treated as having made
19 the election under paragraph (1).

20 “(B) TREATMENT OF ELECTION.—For
21 purposes of paragraph (2), a deemed election
22 under this paragraph—

23 “(i) shall be treated as made as of the
24 first time the taxpayer fails to meet the re-

1 requirements of subsection (c) with respect
2 to the underlying investment, and

3 “(ii) notwithstanding paragraph
4 (2)(B), may be revoked with the consent of
5 the Secretary.

6 “(4) ELECTION FOR INVESTORS IN DEBT IN-
7 STRUMENTS SUBJECT TO SECTION 856.—

8 “(A) IN GENERAL.—A real estate invest-
9 ment trust (as defined in section 856) may elect
10 to include all fixed-rate debt instruments, all
11 contracts to acquire or sell fixed-rate debt in-
12 struments, and all interest rate derivatives in
13 an investment hedging unit under this sub-
14 section. Such election shall be made at such
15 time and in such manner as the Secretary may
16 prescribe and, once made, shall be irrevocable
17 without the consent of the Secretary.

18 “(B) APPLICATION TO EXISTING HEDGING
19 TRANSACTIONS.—

20 “(i) IN GENERAL.—An election under
21 subparagraph (A)—

22 “(I) shall include all derivatives
23 which are part of transactions the tax-
24 payer has, before the effective date of
25 the election, designated under sections

1 856(c)(5)(G) and 1221(a)(7) as hedg-
2 ing transactions of real estate-related
3 borrowings, and

4 “(II) shall be treated as having
5 automatically terminated such des-
6 ignations as of such effective date.

7 Any unrecognized built-in gain or loss with
8 respect to such derivatives as of such effec-
9 tive date shall be taken into account as
10 provided under section 491(b)(4)(A).

11 “(ii) CHANGE IN METHOD OF AC-
12 COUNTING.—The termination of the des-
13 ignation of a derivative as part of a hedg-
14 ing transaction under clause (i) shall be
15 treated as a change in method of account-
16 ing by the taxpayer.

17 “(c) DEFINITIONS AND RULES RELATING TO TAX-
18 PAYERS IDENTIFYING INVESTMENT HEDGING UNITS.—In
19 the case of a taxpayer with respect to which an election
20 is not in effect under subsection (b) with respect to an
21 underlying investment—

22 “(1) IN GENERAL.—The taxpayer shall, at the
23 times described in paragraph (3), test the derivatives
24 with respect to the underlying investment and make
25 the identifications described in paragraph (2).

1 “(2) IDENTIFICATION.—

2 “(A) IN GENERAL.—The taxpayer shall
3 identify the following with respect to an under-
4 lying investment:

5 “(i) Each derivative described in sub-
6 section (a)(1)(B)(i).

7 “(ii) Each portion of the underlying
8 investment described in subsection
9 (a)(1)(B)(ii).

10 “(B) DERIVATIVES AND UNDERLYING IN-
11 VESTMENT NOT PART OF INVESTMENT HEDG-
12 ING UNIT.—A taxpayer shall identify the de-
13 rivatives with respect to an underlying invest-
14 ment, and the portions of the underlying invest-
15 ment, which are not required to be identified
16 under subparagraph (A).

17 “(C) PORTION MAY INCLUDE ALL OF UN-
18 DERLYING INVESTMENT.—For purposes of this
19 part, the term ‘portion’ with respect to any un-
20 derlying investment identified may include all of
21 the underlying investment.

22 “(3) TIMES IDENTIFICATIONS REQUIRED TO BE
23 MADE.—

24 “(A) IN GENERAL.—The taxpayer shall
25 test and make the identifications required

21

1 under this subsection at the following times
2 during any continuous period the taxpayer si-
3 multaneously holds 1 or more derivatives with
4 respect to an underlying investment and 1 or
5 more portions of the underlying investment:

6 “(i) The beginning of the period.

7 “(ii) Immediately after the taxpayer
8 (during such period)—

9 “(I) enters into another deriva-
10 tive with respect to the underlying in-
11 vestment or acquires an additional
12 amount of such underlying invest-
13 ment, or

14 “(II) terminates or transfers 1 or
15 more derivatives with respect to the
16 underlying investment or sells or ex-
17 changes any portion of the underlying
18 investment, except that no testing and
19 identification shall be required under
20 this subclause with respect to any
21 such transaction if the taxpayer does
22 not have an investment hedging unit
23 with respect to the underlying invest-
24 ment immediately before such trans-
25 action.

1 “(iii) Such other times during such
2 period as the Secretary may prescribe by
3 regulations or other guidance.

4 “(B) NO OTHER TIMES FOR TESTING.—
5 Except as provided by the Secretary, there shall
6 not be taken into account for purposes of this
7 part any testing and identification done by the
8 taxpayer with respect to an underlying invest-
9 ment at a time other than the times required
10 under subparagraph (A).

11 “(4) MANNER.—A taxpayer shall be treated as
12 timely making the identifications required under this
13 subsection if the derivatives with respect to, and
14 each portion of, an underlying investment are clearly
15 identified as part of (or as not part of) the invest-
16 ment hedging unit for purposes of this paragraph
17 before the close of the day on which the identifica-
18 tion is required (or such other time as the Secretary
19 may prescribe).

20 “(5) TREATMENT OF INCORRECT IDENTIFICA-
21 TION.—The Secretary shall prescribe regulations or
22 other guidance to properly characterize any income,
23 gain, expense, or loss arising from any derivative or
24 underlying investment which is incorrectly identified

1 under paragraph (2) as being part of, or not being
2 part of, an investment hedging unit.

3 “(d) DELTA.—For purposes of this section—

4 “(1) IN GENERAL.—The term ‘delta’ means,
5 with respect to any derivative and underlying invest-
6 ment, the ratio of the expected change in the fair
7 market value of the derivative to a very small change
8 in the fair market value of the underlying invest-
9 ment.

10 “(2) METHOD OF DETERMINATION.—The delta
11 with respect to any derivative with respect to an un-
12 derlying investment (or any combination of such de-
13 rivatives) shall be determined—

14 “(A) in a commercially reasonable manner,
15 and

16 “(B) except as provided by the Secretary,
17 in a manner which is consistent with the man-
18 ner used by the taxpayer or the taxpayer’s
19 broker for purposes of an applicable financial
20 statement.

21 “(3) TIME FOR MAKING DETERMINATION.—The
22 delta with respect to any derivative and underlying
23 investment shall be determined as of any date the
24 taxpayer is required to make the identifications de-
25 scribed in subsection (c).

1 “(4) MULTIPLE UNDERLYING INVESTMENTS.—

2 “(A) IN GENERAL.—Except as provided in
3 subparagraph (B), if the value of a derivative is
4 determined by reference to more than 1 under-
5 lying investment, the delta shall be determined
6 separately with respect to each underlying in-
7 vestment.

8 “(B) METHODS FOR COMBINATIONS OF
9 UNDERLYING INVESTMENTS.—The Secretary
10 may provide methods for determining the delta
11 of any derivative with respect to combinations
12 of 2 or more underlying investments.

13 “(e) OTHER DEFINITIONS AND RULES.—For pur-
14 poses of this part—

15 “(1) UNDERLYING INVESTMENT.—

16 “(A) IN GENERAL.—The term ‘underlying
17 investment’ means, with respect to any deriva-
18 tive, any item—

19 “(i) which is described in any of the
20 paragraphs (1) through (8) of section
21 493(a) (or any item substantially the same
22 as any such item), and

23 “(ii) by reference to which the value
24 of the derivative, or any payment or other

1 transfer with respect to the derivative, is
2 determined either directly or indirectly.

3 “(B) COORDINATION WITH SECTION 475.—

4 In the case of a dealer in securities to which
5 section 475 applies (and a dealer in commod-
6 ities with respect to which an election is in ef-
7 fect under section 475(e)), such term shall not
8 include any item which, but for this subpara-
9 graph, would be treated as an underlying in-
10 vestment if such item is treated as a security
11 under section 475 (including a commodity
12 treated as a security under section 475(e)).

13 “(C) INDIRECT DETERMINATIONS.—For
14 purposes of subparagraph (A)(ii), the value of,
15 or any payment or other transfer with respect
16 to, a derivative shall not be treated as indirectly
17 determined by reference to one or more of the
18 items described in paragraphs (1) through (8)
19 of section 493(a) solely because the change in
20 a variable affecting such value, payment, or
21 other transfer also affects the value, level,
22 amount, or calculation of such item or items.

23 “(2) ESTABLISHMENT OF INVESTMENT HEDG-
24 ING UNIT.—A taxpayer shall be treated as having

1 established an investment hedging unit with respect
2 to an underlying investment—

3 “(A) in the case of a taxpayer with an
4 election in effect under subsection (b) with re-
5 spect to the underlying investment, as of the
6 date the election takes effect, and

7 “(B) in the case of any other taxpayer, as
8 of the beginning of each applicable hedging pe-
9 riod with respect to the underlying investment.

10 “(3) RELATED PARTIES, ETC.—For purposes of
11 this section—

12 “(A) ATTRIBUTION BETWEEN RELATED
13 PERSONS.—Any derivative or underlying invest-
14 ment held by a related party (within the mean-
15 ing of subsection (f)) with respect to the tax-
16 payer shall be treated as held by the taxpayer.

17 “(B) CERTAIN PASS-THROUGH ENTI-
18 TIES.—If part or all of the income, gain, loss,
19 or expense with respect to a derivative or un-
20 derlying investment held by a partnership,
21 trust, or other entity would properly be taken
22 into account for purposes of this chapter by the
23 taxpayer, then, except to the extent otherwise
24 provided by the Secretary, such derivative or in-

1 vestment shall be treated as held by the tax-
2 payer.

3 “(C) STOCK AND DEBT WHOSE VALUE PRI-
4 MARILY DETERMINED BY REFERENCE TO
5 OTHER ITEMS.—Except as provided by the Sec-
6 retary, if the taxpayer holds an item described
7 in paragraph (1) or (3) of section 493(a) the
8 value of which, or with respect to which any
9 payment or other transfer, is primarily deter-
10 mined by reference to one or more other items
11 described in paragraphs (1) through (8) of sec-
12 tion 493(a), then, solely for purposes of this
13 subpart, such item described in paragraph (1)
14 or (3) of section 493(a) shall also be treated as
15 if it were such other item.

16 “(f) RELATED PARTY.—For purposes of this sec-
17 tion—

18 “(1) IN GENERAL.—A person is a related party
19 to the taxpayer if, with respect to any period during
20 which a derivative or underlying investment is held
21 by such person, such person—

22 “(A) is the taxpayer’s spouse,

23 “(B) is a dependent of the taxpayer or any
24 other taxpayer with respect to whom the tax-
25 payer is a dependent,

1 “(C) is an individual, corporation, partner-
2 ship, trust, or estate which controls, or is con-
3 trolled by (within the meaning of section
4 954(d)(3)), the taxpayer or any individual de-
5 scribed in subparagraph (A) or (B) with respect
6 to the taxpayer (or any combination thereof),

7 “(D) is an individual retirement plan, Ar-
8 cher MSA (as defined in section 220(d)), or
9 health savings account (as defined in section
10 223(d)), of the taxpayer or of any individual de-
11 scribed in subparagraph (A) or (B) with respect
12 to the taxpayer,

13 “(E) is an account under a qualified tui-
14 tion program described in section 529, an
15 ABLE account (as defined in section
16 529A(e)(6)), or a Coverdell education savings
17 account (as defined in section 530(b)) if the
18 taxpayer, or any individual described in sub-
19 paragraph (A) or (B) with respect to the tax-
20 payer, is the designated beneficiary of such ac-
21 count or has the right to make any decision
22 with respect to the investment of any amount in
23 such account,

24 “(F) is an account under—

1 “(i) a plan described in section
2 401(a),

3 “(ii) an annuity plan described in sec-
4 tion 403(a),

5 “(iii) an annuity contract described in
6 section 403(b), or

7 “(iv) an eligible deferred compensa-
8 tion plan described in section 457(b) and
9 maintained by an employer described in
10 section 457(e)(1)(A),

11 if the taxpayer or any individual described in
12 subparagraph (A) or (B) with respect to the
13 taxpayer has the right to make any decision
14 with respect to the investment of any amount in
15 such account, or

16 “(G) files a consolidated return (within the
17 meaning of section 1501) with the taxpayer for
18 any taxable year which includes a portion of
19 such period.

20 “(2) DETERMINATION OF MARITAL STATUS.—

21 “(A) IN GENERAL.—Except as provided in
22 subparagraph (B), marital status shall be deter-
23 mined under section 7703.

1 “(B) SPECIAL RULE FOR MARRIED INDI-
2 VIDUALS FILING SEPARATELY AND LIVING
3 APART.—A husband and wife who—

4 “(i) file separate returns for any tax-
5 able year, and

6 “(ii) live apart at all times during
7 such taxable year,

8 shall not be treated as married individuals.

9 “(g) REGULATIONS.—The Secretary shall prescribe
10 such regulations or other guidance as may be appropriate
11 to carry out this section, including regulations or guidance
12 which require in appropriate cases a taxpayer to bifurcate
13 derivatives described in subsection (d)(4) for purposes of
14 applying this part or which may be necessary to prevent
15 the avoidance of the purposes of subsection (f) (including
16 treating persons as related parties if such persons are
17 formed or availed of to avoid the purposes of such sub-
18 section).

19 **“SEC. 493. DERIVATIVE DEFINED.**

20 “(a) IN GENERAL.—For purposes of this part, except
21 as otherwise provided in this section, the term ‘derivative’
22 means any contract (including any option, forward con-
23 tract, futures contract, short position, swap, or similar
24 contract) the value of which, or any payment or other

1 transfer with respect to which, is (directly or indirectly)
2 determined by reference to one or more of the following:

3 “(1) Any share of stock in a corporation.

4 “(2) Any partnership or beneficial ownership
5 interest in a partnership or trust.

6 “(3) Any evidence of indebtedness.

7 “(4) Except as provided in subsection (b)(1),
8 any real property.

9 “(5) Any commodity which is actively traded
10 (within the meaning of section 1092(c)(4)).

11 “(6) Any currency.

12 “(7) Any rate, price, amount, index, formula, or
13 algorithm.

14 “(8) Any other item which the Secretary may
15 prescribe.

16 Except as provided by the Secretary to prevent the avoid-
17 ance of the purposes of this part, such term shall not in-
18 clude any item described in paragraphs (1) through (8).

19 For purposes of this subsection, the value of, or any pay-
20 ment or other transfer with respect to, a contract shall
21 not be treated as indirectly determined by reference to one
22 or more of the items described in paragraphs (1) through
23 (8) solely because the change in a variable affecting such
24 value, payment, or other transfer also affects the value,
25 level, amount, or calculation of such item or items.

1 “(b) EXCEPTIONS.—

2 “(1) CERTAIN REAL PROPERTY.—

3 “(A) IN GENERAL.—For purposes of this
4 part, the term ‘derivative’ shall not include any
5 contract with respect to interests in real prop-
6 erty (as defined in section 856(c)(5)(C)) if such
7 contract requires physical delivery of such real
8 property.

9 “(B) OPTIONS TO SETTLE IN CASH.—

10 “(i) IN GENERAL.—For purposes of
11 subparagraph (A), a contract which pro-
12 vides for an option of cash settlement shall
13 not be treated as requiring physical deliv-
14 ery of real property unless the option is ex-
15 ercisable only in unusual and exceptional
16 circumstances.

17 “(ii) OPTION OF CASH SETTLE-
18 MENT.—For purposes of clause (i), a con-
19 tract provides an option of cash settlement
20 if the contract settles in (or could be set-
21 tled in) cash or property other than the
22 underlying real property.

23 “(2) HEDGING TRANSACTIONS.—

24 “(A) IN GENERAL.—For purposes of this
25 part, the term ‘derivative’ shall not include any

1 contract which is part of a hedging transaction
2 (as defined in section 1221(b)).

3 “(B) SECTION 988 HEDGING TRANS-
4 ACTIONS.—For exception for section 988 hedg-
5 ing transactions, see section 988(d)(1).

6 “(3) SECURITIES LENDING, SALE-REPURCHASE,
7 AND SIMILAR FINANCING TRANSACTIONS.—To the
8 extent provided by the Secretary, for purposes of
9 this part, the term ‘derivative’ shall not include the
10 right to the return of the same or substantially iden-
11 tical securities transferred in a securities lending
12 transaction, sale-repurchase transaction, or similar
13 financing transaction.

14 “(4) OPTIONS RECEIVED IN CONNECTION WITH
15 THE PERFORMANCE OF SERVICES.—For purposes of
16 this part, the term ‘derivative’ shall not include any
17 option described in section 83(e)(3) received in con-
18 nection with the performance of services.

19 “(5) INSURANCE, ANNUITY, AND ENDOWMENT
20 CONTRACTS.—For purposes of this part, the term
21 ‘derivative’ shall not include any insurance, annuity,
22 or endowment contract issued by an insurance com-
23 pany to which subchapter L applies (or issued by
24 any foreign corporation to which such subchapter

1 would apply if such foreign corporation were a do-
2 mestic corporation).

3 “(6) DERIVATIVES WITH RESPECT TO STOCK
4 OF MEMBERS OF SAME WORLDWIDE AFFILIATED
5 GROUP.—

6 “(A) IN GENERAL.—For purposes of this
7 part, the term ‘derivative’ shall not include any
8 derivative (determined without regard to this
9 paragraph) with respect to stock issued by any
10 member of the same worldwide affiliated group
11 in which the taxpayer is a member.

12 “(B) WORLDWIDE AFFILIATED GROUP.—
13 For purposes of this paragraph, the term
14 ‘worldwide affiliated group’ means a group con-
15 sisting of—

16 “(i) the includible members of an af-
17 filiated group (as defined in section
18 1504(a), determined without regard to
19 paragraph (2) of section 1504(b)), and

20 “(ii) all controlled foreign corpora-
21 tions in which such members in the aggre-
22 gate meet the ownership requirements of
23 section 1504(a)(2) either directly or indi-
24 rectly through applying paragraph (2) of
25 section 958(a) or through applying rules

1 similar to the rules of such paragraph to
2 stock owned directly or indirectly by do-
3 mestic partnerships, trusts, or estates.

4 “(7) COMMODITIES USED IN NORMAL COURSE
5 OF TRADE OR BUSINESS.—For purposes of this part,
6 the term ‘derivative’ shall not include any contract
7 with respect to any commodity if—

8 “(A) such contract requires physical deliv-
9 ery with the option of cash settlement only in
10 unusual and exceptional circumstances, and

11 “(B) such commodity is used (and is used
12 in quantities with respect to which such deriva-
13 tive relates) in the normal course of the tax-
14 payer’s trade or business (or, in the case of an
15 individual, for personal consumption).

16 “(c) CONTRACTS WITH EMBEDDED DERIVATIVE
17 COMPONENTS.—

18 “(1) IN GENERAL.—If a contract has derivative
19 and nonderivative components, then each derivative
20 component shall be treated as a derivative for pur-
21 poses of this part. If the derivative component can-
22 not be separately valued, then the entire contract
23 shall be treated as a derivative for purposes of this
24 part.

1 “(2) EXCEPTION FOR CERTAIN EMBEDDED DE-
2 RIVATIVE COMPONENTS OF DEBT INSTRUMENTS.—A
3 debt instrument shall not be treated as having a de-
4 rivative component merely because—

5 “(A) such debt instrument is denominated
6 in a nonfunctional currency (as defined in sec-
7 tion 988(c)(1)(C)(ii)), or

8 “(B) payments with respect to such debt
9 instrument are determined by reference to the
10 value of a nonfunctional currency (as so de-
11 fined).

12 “(d) TREATMENT OF AMERICAN DEPOSITORY RE-
13 CEIPTS AND SIMILAR INSTRUMENTS.—Except as other-
14 wise provided by the Secretary, for purposes of this part,
15 American depository receipts (and similar instruments)
16 with respect to shares of stock in foreign corporations
17 shall be treated as shares of stock in such foreign corpora-
18 tions.

19 **“Subpart B—Similar Contracts**

 “Sec. 494. Tax treatment of contracts similar to derivatives.

20 **“SEC. 494. TAX TREATMENT OF CONTRACTS SIMILAR TO**
21 **DERIVATIVES.**

22 “(a) IN GENERAL.—For purposes of this title, if
23 there is a taxable transaction with respect to any applica-
24 ble property interest, then, notwithstanding any other pro-

1 vision of this title other than section 1032, gain or loss
2 attributable to the taxable transaction shall be considered
3 gain or loss from the sale or exchange of property which
4 has the same character as the property to which the appli-
5 cable property interest relates has (or would have) in the
6 hands of the taxpayer.

7 “(b) DEFINITIONS.—For purposes of this section—

8 “(1) APPLICABLE PROPERTY INTEREST.—The
9 term ‘applicable property interest’ means any right
10 or obligation with respect to property other than—

11 “(A) a derivative (as defined in section
12 493), or

13 “(B) any position in applicable property to
14 which section 1092 applies.

15 “(2) TAXABLE TRANSACTION.—The term ‘tax-
16 able transaction’ means, with respect to any applica-
17 ble property interest—

18 “(A) any termination or transfer (as de-
19 fined in section 491(c)(3)) of such interest, or

20 “(B) any payment in fulfillment or partial
21 fulfillment of such interest.”.

22 **SEC. 3. COORDINATION OF NEW RULES WITH EXISTING**
23 **RULES.**

24 (a) COORDINATION WITH RULES FOR DEALERS AND
25 TRADERS.—

1 (1) DERIVATIVES NOT TREATED AS SECURI-
2 TIES.—Section 475(e)(2) is amended—

3 (A) by adding “and” at the end of sub-
4 paragraph (C),

5 (B) by striking subparagraphs (D) and (E)
6 and by redesignating subparagraph (F) as sub-
7 paragraph (D),

8 (C) by striking “subparagraph (A), (B),
9 (C), (D), or (E)” in subparagraph (D)(i), as so
10 redesignated, and inserting “subparagraph (A),
11 (B), or (C)”, and

12 (D) by amending the last sentence to read
13 as follows: “Such term shall not include any de-
14 rivative to which section 491(a) applies.”.

15 (2) DERIVATIVES NOT TREATED AS COMMOD-
16 ITIES.—Section 475(e)(2) is amended—

17 (A) by adding “and” at the end of sub-
18 paragraph (A),

19 (B) by striking subparagraphs (B) and (C)
20 and by redesignating subparagraph (D) as sub-
21 paragraph (B), and

22 (C) by striking “subparagraph (A), (B) or
23 (C)” in subparagraph (B)(i), as so redesign-
24 ated, and inserting “subparagraph (A)”.

25 (3) CONFORMING AMENDMENTS.—

1 (A) Section 475(b) is amended by striking
2 paragraph (4).

3 (B) Section 475(d)(2)(B) is amended—

4 (i) by striking “subsection
5 (c)(2)(F)(iii)” and inserting “subsection
6 (c)(2)(D)(iii)”, and

7 (ii) by striking “subsection (c)(2)(F)”
8 and inserting “subsection (c)(2)(D)”.

9 (C) Section 475(f)(1)(D) is amended by
10 striking “subsections (b)(4) and (d)” and in-
11 serting “subsection (d)”.

12 (b) COORDINATION WITH STRADDLE RULES.—

13 (1) IN GENERAL.—Section 1092 is amended to
14 read as follows:

15 **“SEC. 1092. STRADDLES.**

16 “(a) RECOGNITION OF LOSS IN CASE OF STRAD-
17 DLES, ETC.—

18 “(1) LIMITATION ON RECOGNITION OF LOSS.—

19 “(A) IN GENERAL.—Any loss with respect
20 to 1 or more positions shall be taken into ac-
21 count for any taxable year only to the extent
22 that the amount of such loss exceeds the unrec-
23 ognized gain (if any) with respect to 1 or more
24 positions which were offsetting positions with

1 respect to 1 or more positions from which the
2 loss arose.

3 “(B) CARRYOVER OF LOSS.—Any loss
4 which may not be taken into account under
5 subparagraph (A) for any taxable year shall,
6 subject to the limitations under subparagraph
7 (A), be treated as sustained in the succeeding
8 taxable year.

9 “(2) UNRECOGNIZED GAIN.—For purposes of
10 this subsection—

11 “(A) IN GENERAL.—The term ‘unrecog-
12 nized gain’ means—

13 “(i) in the case of any position held
14 by the taxpayer as of the close of the tax-
15 able year, the amount of gain which would
16 be taken into account with respect to such
17 position if such position were sold on the
18 last business day of such taxable year at
19 its fair market value, and

20 “(ii) in the case of any position with
21 respect to which, as of the close of the tax-
22 able year, gain has been realized but not
23 recognized, the amount of gain so realized.

24 “(B) REPORTING OF GAIN.—Each tax-
25 payer shall disclose to the Secretary, at such

1 time and in such manner and form as the Sec-
2 retary may prescribe—

3 “(i) each position (whether or not
4 part of a straddle) with respect to which,
5 as of the close of the taxable year, there is
6 unrecognized gain, and

7 “(ii) the amount of such unrecognized
8 gain.

9 The Secretary may waive the requirement to re-
10 port under this subparagraph with respect to
11 any position if such reporting is not required to
12 carry out the purposes of this section.

13 “(3) SPECIAL RULES FOR PHYSICALLY SET-
14 TLED POSITIONS.—For purposes of this subsection,
15 if a taxpayer settles a position which is part of a
16 straddle by delivering property to which the position
17 relates (and such position, if terminated, would re-
18 sult in a realization of a loss), then such taxpayer
19 shall be treated as if such taxpayer—

20 “(A) terminated the position for its fair
21 market value immediately before the settlement,
22 and

23 “(B) sold the property so delivered by the
24 taxpayer at its fair market value.

1 “(b) REGULATIONS.—The Secretary shall prescribe
2 such regulations with respect to gain or loss on positions
3 which are a part of a straddle as may be appropriate to
4 carry out the purposes of this section and section 263(g).
5 To the extent consistent with such purposes, such regula-
6 tions shall include rules applying the principles of sub-
7 sections (a) and (d) of section 1091 and of subsections
8 (b) and (d) of section 1233 (as in effect before their re-
9 peal).

10 “(c) DEFINITIONS AND RULES RELATING TO STRAD-
11 DLES.—For purposes of this section—

12 “(1) STRADDLE DEFINED.—The term ‘straddle’
13 means offsetting positions with respect to applicable
14 property.

15 “(2) OFFSETTING POSITIONS.—A taxpayer
16 holds offsetting positions with respect to applicable
17 property if the taxpayer holds any position which by
18 itself, or in combination with 1 or more other posi-
19 tions held by the taxpayer, has a delta (within the
20 meaning of section 492(d)(1)) with respect to any
21 other position held by the taxpayer which is within
22 the range beginning with minus 0.7 and ending with
23 minus 1.0. For purposes of this paragraph, positions
24 shall be taken into account whether or not they are
25 in the same applicable property.

1 “(3) DETERMINATION OF DELTA.—For pur-
2 poses of this section—

3 “(A) METHOD OF DETERMINATION.—The
4 delta with respect to any position in applicable
5 property with respect to another position in ap-
6 plicable property (or any combination of such
7 positions) shall be determined in the same man-
8 ner as under section 492(d)(2).

9 “(B) TIMING OF DELTA DETERMINATION
10 AND OTHER SPECIAL RULES.—Rules similar to
11 the rules of paragraphs (3) and (4) of section
12 492(d) shall apply for purposes of this para-
13 graph.

14 “(4) APPLICABLE PROPERTY AND POSITION DE-
15 FINED.—

16 “(A) APPLICABLE PROPERTY.—The term
17 ‘applicable property’ means any item which is—

18 “(i) described in paragraph (1), (2),
19 (3), (5), (6), (7), or (8) of section 493(a)
20 (or any item substantially the same as any
21 such item), and

22 “(ii) of a type which is actively trad-
23 ed.

24 “(B) POSITION.—

1 “(i) IN GENERAL.—The term ‘posi-
2 tion’ means an interest in applicable prop-
3 erty.

4 “(ii) DERIVATIVES EXCLUDED.—Such
5 term shall not include a derivative (as de-
6 fined in section 493).

7 “(C) STOCK AND DEBT WHOSE VALUE PRI-
8 MARILY DETERMINED BY REFERENCE TO
9 OTHER ITEMS.—Except as provided in regula-
10 tions, if the taxpayer holds an item described in
11 paragraph (1) or (3) of section 493(a) the value
12 of which, or with respect to which any payment
13 or other transfer, is primarily determined by
14 reference to one or more other items described
15 in paragraphs (1) through (8) of section
16 493(a), then, solely for purposes of this section,
17 such item described in paragraph (1) or (3) of
18 section 493(a) shall also be treated as if it were
19 such other item.

20 “(5) POSITIONS HELD BY RELATED PERSONS,
21 ETC.—

22 “(A) IN GENERAL.—In determining wheth-
23 er 2 or more positions are offsetting, the tax-
24 payer shall be treated as holding any position

1 held by a related party (within the meaning of
2 section 492(f)).

3 “(B) CERTAIN PASS-THROUGH ENTI-
4 TIES.—If part or all of the gain or loss with re-
5 spect to a position held by a partnership, trust,
6 or other entity would properly be taken into ac-
7 count for purposes of this chapter by a tax-
8 payer, then, except to the extent otherwise pro-
9 vided by the Secretary, such position shall be
10 treated as held by the taxpayer.

11 “(6) SPECIAL RULES FOR FOREIGN CUR-
12 RENCY.—

13 “(A) POSITION TO INCLUDE INTEREST IN
14 CERTAIN DEBT.—For purposes of paragraph
15 (4)(B)(i), an obligor’s interest in a nonfunc-
16 tional currency denominated debt obligation is
17 treated as a position in the nonfunctional cur-
18 rency.

19 “(B) ACTIVELY TRADED REQUIREMENT.—
20 For purposes of paragraph (4)(A)(ii), foreign
21 currency for which there is an active interbank
22 market is presumed to be actively traded.

23 “(d) EXCEPTION FOR HEDGING TRANSACTIONS AND
24 INVESTMENT HEDGING UNITS.—This section shall not
25 apply in the case of—

1 “(1) any hedging transaction (as defined in sec-
2 tion 1221(b)), and

3 “(2) any investment hedging unit (as defined in
4 section 492).

5 “(e) CROSS REFERENCE.—For provisions requiring
6 capitalization of certain interest and carrying charges
7 where there is a straddle, see section 263(g).”.

8 (2) CONFORMING AMENDMENTS.—The last sen-
9 tence of section 246(c)(4) is amended—

10 (A) by inserting “(as in effect before its re-
11 peal)” after “section 1092(c)(4)”, and

12 (B) by inserting “(as so in effect)” after
13 “section 1092(f)”.

14 (c) DEBT INSTRUMENTS HELD BY INSURANCE COM-
15 PANIES.—

16 (1) IN GENERAL.—Subsection (a) of section
17 1221 is amended by striking “or” at the end of
18 paragraph (7), by striking the period at the end of
19 paragraph (8) and inserting “; or”, and by adding
20 at the end the following:

21 “(9) any bond, debenture, note, or certificate or
22 other evidence of indebtedness held by an applicable
23 insurance company (as defined in subsection
24 (b)(5)).”.

1 (2) APPLICABLE INSURANCE COMPANY.—Sec-
2 tion 1221(b), as amended by this Act, is amended
3 by adding at the end the following:

4 “(5) APPLICABLE INSURANCE COMPANY.—For
5 purposes of subsection (a)(9)—

6 “(A) IN GENERAL.—The term ‘applicable
7 insurance company’ means, with respect to any
8 taxable year, an insurance company (as defined
9 in the last sentence of section 816(a))—

10 “(i) which is subject to tax under sec-
11 tion 801(a) or section 831(a),

12 “(ii) with respect to which sections
13 831(b), 835, and 842 do not apply, and

14 “(iii) which is not treated as a stock
15 insurance company solely by reason of sec-
16 tion 833(a)(1).

17 “(B) PERMANENT TREATMENT BY COM-
18 PANY AS ORDINARY ASSET.—If an asset is
19 treated as an asset described in subsection
20 (a)(9) with respect to any applicable insurance
21 company for any taxable year, such asset shall
22 be treated as so described during any subse-
23 quent taxable year such asset is held by such
24 company.”.

1 (3) REGULATIONS.—Paragraph (4) of section
2 1221(b) is amended—

3 (A) by striking “The Secretary” and in-
4 serting:

5 “(A) RELATED PARTIES.—The Secretary”,
6 and

7 (B) by adding at the end the following:

8 “(B) ASSETS OF INSURANCE COMPA-
9 NIES.—The Secretary shall prescribe such regu-
10 lations as may be necessary or appropriate to
11 carry out the purposes of subsection (a)(9), in-
12 cluding such regulations as may be necessary to
13 prevent the avoidance of Federal income tax
14 through the sale or exchange of assets described
15 in such subsection.”.

16 (4) EFFECTIVE DATE.—

17 (A) IN GENERAL.—The amendments made
18 by this subsection shall apply to any bond, de-
19 benture, note, or certificate or other evidence of
20 indebtedness held or acquired after the 90-day
21 period beginning with the date of the enactment
22 of this Act.

23 (B) TRANSITION RULE.—If a taxpayer has
24 a capital loss carryover to any taxable year of
25 the taxpayer beginning after the close of the

1 90-day period described in subparagraph (A),
2 the taxpayer shall, in addition to other short-
3 term capital gain of the taxpayer (if any), treat
4 as short-term capital gain (rather than as ordi-
5 nary income) an amount equal to the lesser
6 of—

7 (i) the net gain (if any) from sales or
8 exchanges during such taxable year of as-
9 sets to which section 1221(a)(9) of such
10 Code (as added by paragraph (1)) applies,
11 or

12 (ii) the capital loss carryovers to such
13 taxable year from taxable years beginning
14 before the close of such period.

15 (d) RICS ALLOWED NET OPERATING LOSS DEDUC-
16 TION.—

17 (1) IN GENERAL.—Paragraph (2) of section
18 852(b) is amended by striking subparagraph (B)
19 and by redesignating subparagraphs (C) through (G)
20 as subparagraphs (B) through (F), respectively.

21 (2) OTHER MODIFICATIONS.—Paragraph (6) of
22 section 172(d) is amended to read follows:

23 “(6) MODIFICATIONS RELATED TO RICS AND
24 REITS.—In the case of any taxable year for which

1 part I or II of subchapter M applies to the tax-
2 payer—

3 “(A) the net operating loss for such tax-
4 able year shall be computed by taking into ac-
5 count—

6 “(i) in the case of a regulated invest-
7 ment company, the adjustments described
8 in section 852(b)(2) (other than the deduc-
9 tion for dividends paid described in sub-
10 paragraph (C) thereof)), and

11 “(ii) in the case of a real estate in-
12 vestment trust, the adjustments described
13 in section 857(b)(2) (other than the deduc-
14 tion for dividends paid described in sub-
15 paragraph (B) thereof),

16 “(B) where such taxable year is a ‘prior
17 taxable year’ referred to in paragraph (2) of
18 subsection (b), references in such paragraph to
19 ‘taxable income’ shall be treated as references
20 to—

21 “(i) in the case of a regulated invest-
22 ment company, regulated investment com-
23 pany taxable income (as defined in section
24 852(b)(2)), and

1 “(ii) in the case of a real estate in-
2 vestment trust, real estate investment tax-
3 able income (as defined in section
4 857(b)(2)), and

5 “(C) subsection (a)(2) shall be applied by
6 treating references to taxable income as ref-
7 erences to—

8 “(i) in the case of a regulated invest-
9 ment company, regulated investment com-
10 pany taxable income (as defined in section
11 852(b)(2)) but without regard to the de-
12 duction for dividends paid (as defined in
13 section 561), and

14 “(ii) in the case of a real estate in-
15 vestment trust, real estate investment tax-
16 able income (as defined in section
17 857(b)(2)) but without regard to the de-
18 duction for dividends paid (as defined in
19 section 561).”.

20 (3) CONFORMING AMENDMENTS.—

21 (A) Section 443(e)(3) is amended by strik-
22 ing “section 852(b)(2)(D)” and inserting “sec-
23 tion 852(b)(2)(C)”.

1 (B) Section 852(a)(1)(A) is amended by
2 striking “subsection (b)(2)(D)” and inserting
3 “subsection (b)(2)(C)”.

4 (C) Section 4982(e)(1)(A) is amended by
5 striking “and (D)” and inserting “and (C)”.

6 (4) EFFECTIVE DATE.—The amendments made
7 by this subsection shall apply to net operating losses
8 for taxable years ending after the 90th day after the
9 date of the enactment of this Act.

10 (e) NONRECOGNITION OF GAIN OR LOSS FROM
11 TRANSACTIONS BY A CORPORATION WITH RESPECT TO
12 ITS STOCK.—

13 (1) IN GENERAL.—Section 1032 is amended to
14 read as follows:

15 **“SEC. 1032. TRANSACTIONS BY A CORPORATION WITH RE-**
16 **SPECT TO ITS STOCK.**

17 “(a) NONRECOGNITION ON EXCHANGE OF STOCK
18 FOR PROPERTY.—No gain or loss shall be recognized to
19 a corporation on the receipt of money or other property
20 in exchange for stock of such corporation.

21 “(b) DERIVATIVE TRANSACTIONS BY A CORPORATION
22 WITH RESPECT TO ITS STOCK.—

23 “(1) IN GENERAL.—Except as otherwise pro-
24 vided in this subsection, section 1032 derivative
25 items of a corporation shall not be taken into ac-

1 count in determining such corporation's liability for
2 tax under this subtitle.

3 “(2) INCOME RECOGNITION ON CERTAIN FOR-
4 WARD CONTRACTS.—

5 “(A) IN GENERAL.—If—

6 “(i) a corporation acquires its stock,
7 and

8 “(ii) such acquisition is part of a plan
9 (or series of related transactions) pursuant
10 to which the corporation enters into a for-
11 ward contract with respect to its stock,

12 such corporation shall include amounts in in-
13 come as if the excess of the amount to be re-
14 ceived under the forward contract over the fair
15 market value of the stock as of the date the
16 corporation entered into the forward contract
17 were original issue discount on a debt instru-
18 ment acquired on such date. The preceding sen-
19 tence shall apply only to the extent that the
20 amount of stock involved in the forward con-
21 tract does not exceed the amount acquired as
22 described in clause (i).

23 “(B) PLAN PRESUMED TO EXIST.—If a
24 corporation enters into a forward contract with
25 respect to its stock within the 60-day period be-

1 ginning on the date which is 30 days before the
2 date that the corporation acquires its stock,
3 such acquisition shall be treated as pursuant to
4 a plan described in subparagraph (A)(ii) unless
5 it is established that entering into such contract
6 and such acquisition are not pursuant to a plan
7 or series of related transactions.

8 “(c) SECTION 1032 DERIVATIVE ITEMS.—For pur-
9 poses of this section, the term ‘section 1032 derivative
10 item’ means, with respect to any corporation, any item of
11 income, gain, loss, or deduction if—

12 “(1) such item arises out of the rights or obli-
13 gations under any derivative (as defined in section
14 493) to the extent such derivative relates to the cor-
15 poration’s stock (or is attributable to any transfer or
16 extinguishment of any such right or obligation), or

17 “(2) such item arises under any other contract
18 or position but only to the extent that such item re-
19 flects (or is determined by reference to) changes in
20 the value of such stock or distributions thereon.

21 Such term shall not include any deduction with respect
22 to which section 83(h) applies and shall not include any
23 deduction for any item which is in the nature of compensa-
24 tion for services rendered. For purposes of this subpara-

1 graph, de minimis relationships, as determined by the Sec-
2 retary, shall be disregarded.

3 “(d) COORDINATION WITH DERIVATIVE AND STRAD-
4 DLE RULES.—In the case of a derivative or other contract
5 or position described in subsection (c) which is held by
6 a corporation with respect to its stock—

7 “(1) this section (rather than part IV of sub-
8 chapter E or section 1092) shall apply in deter-
9 mining the treatment of section 1032 derivative
10 items under this subtitle, and

11 “(2) such derivative or other contract or posi-
12 tion shall not be taken into account in determining
13 whether the corporation has an investment hedging
14 unit, applicable property interest, or straddle with
15 respect to its stock for purposes of such part or sec-
16 tion.

17 “(e) REGULATIONS.—The Secretary shall prescribe
18 such regulations or other guidance as may be appropriate
19 to carry out the purposes of this section, including regula-
20 tions or other guidance which treat the portion of an in-
21 strument which is described in subsection (c)(1) separately
22 from the portion of such instrument which is not so de-
23 scribed.

1 “(f) BASIS.—For basis of property acquired by a cor-
2 poration in certain exchanges for its stock, see section
3 362.”.

4 (2) CLERICAL AMENDMENT.—The item relating
5 to section 1032 in the table of sections for part III
6 of subchapter O of chapter 1 is amended to read as
7 follows:

“Sec. 1032. Transactions by a corporation with respect to its stock.”.

8 (3) EFFECTIVE DATE.—The amendments made
9 by this subsection shall apply to transactions entered
10 into after the date of the enactment of this Act.

11 (f) COORDINATION WITH SECTION 856 FOR INVEST-
12 MENT HEDGING UNIT ELECTION BY REAL ESTATE IN-
13 VESTMENT TRUSTS.—Section 856(c)(5) is amended by
14 adding at the end the following new subparagraph:

15 “(M) TREATMENT OF CERTAIN INSTRU-
16 MENTS IN AN INVESTMENT HEDGING UNIT.—

17 “(i) IN GENERAL.—Any income of a
18 real estate investment trust from trans-
19 actions that are entered to manage the risk
20 of interest rate or price changes with re-
21 spect to real estate assets acquired or to be
22 acquired and held in an investment hedg-
23 ing unit for which the trust has made an
24 election under section 492(b)(4) shall not

1 constitute gross income under paragraphs
2 (2) and (3).

3 “(ii) SPECIAL RULES.—For purposes
4 of clause (i)—

5 “(I) gross income from deriva-
6 tives and the underlying investment
7 included in such investment hedging
8 unit shall be computed by treating
9 each investment and each derivative
10 as a separate position, and

11 “(II) gross gain from each posi-
12 tion shall be determined under section
13 491.”.

14 **SEC. 4. TECHNICAL AND CONFORMING AMENDMENTS.**

15 (a) REPEAL OF CERTAIN OTHER SUPERCEDED
16 RULES FOR DETERMINING CAPITAL GAINS AND
17 LOSSES.—

18 (1) IN GENERAL.—Part IV of subchapter P of
19 chapter 1 is amended by striking sections 1233,
20 1234, 1234A, 1234B, 1236, 1256, 1258, 1259, and
21 1260 (and by striking the items relating to such sec-
22 tions in the table of sections for such part).

23 (2) CONFORMING AMENDMENTS RELATED TO
24 REPEAL OF SECTION 1234.—Section 6045(h)(2) is
25 amended—

1 (A) by striking “(as defined in section
2 1234(b)(2)(A))”, and

3 (B) by adding at the end the following:
4 “For purposes of the preceding sentence, the
5 term ‘closing transaction’ means any termi-
6 nation of the taxpayer’s obligation under an op-
7 tion in property other than through the exercise
8 or lapse of the option.”.

9 (3) CONFORMING AMENDMENTS RELATED TO
10 REPEAL OF SECTION 1236.—

11 (A) Section 475(d)(3)(A) is amended by
12 striking “or section 1236(b)”.

13 (B) Section 512(b)(5) is amended by strik-
14 ing “section 1236(c)” and inserting “section
15 1058(c)”.

16 (C) Section 1058 is amended—

17 (i) by striking “(as defined in section
18 1236(c))” in subsection (a), and

19 (ii) by redesignating subsection (c) as
20 subsection (d) and by inserting after sub-
21 section (b) the following new subsection:

22 “(c) SECURITIES.—For purposes of this section, the
23 term ‘security’ means any share of stock in any corpora-
24 tion, certificate of stock or interest in any corporation,
25 note, bond, debenture, or evidence of indebtedness, or any

1 evidence of an interest in or right to subscribe to or pur-
2 chase any of the foregoing.”.

3 (4) CONFORMING AMENDMENTS RELATED TO
4 REPEAL OF SECTION 1256.—

5 (A) Section 461(i)(3)(B) is amended to
6 read as follows:

7 “(B) any partnership or other entity (other
8 than a corporation which is not an S corpora-
9 tion) if more than 35 percent of the losses of
10 such entity during the taxable year are allocable
11 to limited partners or limited entrepreneurs
12 (within the meaning of subsection (k)(4)),
13 and”.

14 (B) Section 475(d)(1) is amended by strik-
15 ing “sections 263(g), 263A, and 1256(a)” and
16 inserting “sections 263(g) and 263A”.

17 (C) Section 988(e)(1) is amended by strik-
18 ing subparagraphs (D) and (E).

19 (D) Section 1212 is amended by striking
20 subsection (c).

21 (E) Section 1223 is amended by striking
22 paragraphs (7) and (14).

23 (F) Section 1281(b)(1)(E) is amended to
24 read as follows:

1 “(E) is part of a hedging transaction (as
2 defined in section 1221(b)) or an investment
3 hedging unit (as defined in section 492), or”.

4 (G) Section 1402 is amended by striking
5 subsection (i).

6 (H) Section 4982(e)(6)(B) is amended by
7 striking “sections 1256 and 1296” and insert-
8 ing “sections 491 and 1296”.

9 (5) CONFORMING AMENDMENTS RELATED TO
10 REPEAL OF SECTION 1259.—Section 475(f)(1) is
11 amended by striking subparagraph (C) and by redesi-
12 gnating subparagraph (D) as subparagraph (C).

13 (b) OTHER CONFORMING AMENDMENTS.—

14 (1) Section 355(g)(2)(B)(i)(V) is amended to
15 read as follows:

16 “(V) any derivative (as defined in
17 section 493),”.

18 (2) Section 856(n)(4) is amended by inserting
19 “or derivatives (as defined in section 493)” after
20 “securities (as defined in section 475(e)(2))”.

21 (3) Section 857(e)(2)(C)(i) is amended by strik-
22 ing “section 860E or 1272” and inserting “section
23 491, 860E, or 1272”.

24 (4) Section 988(d)(1) is amended—

1 (A) by striking “or 1256” and inserting
2 “or 491”, and

3 (B) by striking “1092, and 1256” and in-
4 serting “491, and 1092”.

5 (5) Section 1091(e) is amended to read as fol-
6 lows:

7 “(e) COORDINATION WITH MARK TO MARKET OF
8 DERIVATIVES AND UNDERLYING INVESTMENTS.—For
9 purposes of this section, the term ‘stock or securities’ shall
10 not include—

11 “(1) any derivative (as defined in section 493),
12 or

13 “(2) any underlying investment (as defined in
14 section 492(e)(1)) which, at the time of the sale or
15 other disposition, is part of an investment hedging
16 unit (as defined in section 492).”.

17 (6)(A) Section 1221(a)(6) is amended to read
18 as follows:

19 “(6) any—

20 “(A) derivative (as defined in section 493),
21 or

22 “(B) any underlying investment (as de-
23 fined in section 492(e)(1)) which is part of an
24 investment hedging unit (as defined in section
25 492).”.

1 (B) Section 1221(b) is amended by striking
2 paragraph (1).

3 (7) Section 4975(f)(11)(D) is amended by
4 striking clauses (i) and (ii) and inserting the fol-
5 lowing:

6 “(i) SECURITY.—The term ‘security’
7 means any security described in section
8 475(e)(2) (without regard to subparagraph
9 (D)(iii) thereof) and any derivative with re-
10 spect to such a security (within the mean-
11 ing of section 493).

12 “(ii) COMMODITY.—The term ‘com-
13 modity’ means any commodity described in
14 section 475(e)(2) (without regard to sub-
15 paragraph (B)(iii) thereof) and any deriva-
16 tive with respect to such a commodity
17 (within the meaning of section 493).”.

18 (8) The table of parts for subchapter E of
19 chapter 1 is amended by adding at the end the fol-
20 lowing new item:

“PART IV. TAX TREATMENT OF DERIVATIVES AND SIMILAR CONTRACTS”.

21 **SEC. 5. EFFECTIVE DATES.**

22 (a) IN GENERAL.—Except as provided in this Act—

23 (1) the amendments made by section 2 shall
24 apply to taxable events occurring after the 90-day
25 period beginning with the date of the enactment of

1 this Act, in taxable years ending after the last day
2 of such period, and

3 (2) the amendments made by sections 3 and 4
4 shall apply to derivatives and underlying investments
5 held after the last day of such period.

6 (b) IDENTIFICATION REQUIREMENTS.—If, as of the
7 close of the 90-day period described in subsection (a)(1),
8 a taxpayer simultaneously holds 1 or more derivatives with
9 respect to an underlying investment and the underlying
10 investment—

11 (1) the taxpayer shall make the identifications
12 required under section 492(c)(2) of Internal Rev-
13 enue Code of 1986 (as added by section 2 of this
14 Act) before the close of such period, and

15 (2) if such identifications result in an invest-
16 ment hedging unit, the first applicable hedging pe-
17 riod with respect to such unit shall begin on the day
18 after the close of such period.

19 (c) DEFINITIONS.—For purposes of this section, any
20 term used in this section which is also used in part IV
21 of subchapter E of chapter 1 of such Code (as so added)
22 shall have the same meaning as when used in such part.