

114TH 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

_____ 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 2016”.

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—DERIVATIVES**

“Sec. 491. Rules for treatment of derivatives.

“Sec. 492. Investment hedging units.

“Sec. 493. Derivative defined.

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

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

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

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

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

22 “(1) CHARACTER AND SOURCE OF GAIN OR
23 LOSS.—

1 “(A) CHARACTER.—Any item of income,
2 deduction, gain, or loss taken into account
3 under subsection (a) with respect to a taxable
4 event shall be treated as—

5 “(i) ordinary income or loss, and

6 “(ii) attributable to a trade or busi-
7 ness of the taxpayer for purposes of sec-
8 tion 172(d)(4).

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

16 “(2) DETERMINATION OF AMOUNT.—

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

20 “(i) in the case of a taxable event in-
21 volving the termination or transfer of a de-
22 rivative or the sale or exchange of an un-
23 derlying investment, the amount of gain or
24 loss determined under this title with re-
25 spect to the taxable event, or

1 “(ii) in the case of any other taxable
2 event, the amount of gain or loss which
3 would be determined under this title if, im-
4 mediately before the taxable event—

5 “(I) in the case of a derivative,
6 the derivative were terminated or
7 transferred at its fair market value, or

8 “(II) in the case of an underlying
9 investment, the investment were sold
10 or exchanged at its fair market value.

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

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

16 “(ii) determined under an applicable
17 financial statement.

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

20 “(A) IN GENERAL.—In the case of a tax-
21 able event described in subsection (c)(2) with
22 respect to a derivative or underlying investment
23 (other than a termination or transfer of the de-
24 rivative or the sale or exchange of the under-
25 lying investment), notwithstanding subsection

1 (a), built-in loss (if any) shall not be recognized
2 and shall not be taken into account by reason
3 of such taxable event.

4 “(B) IDENTIFICATION.—For purposes of
5 this paragraph, the determination of which por-
6 tions of an underlying investment have been
7 sold or exchanged in a taxable event shall be
8 made on a first-in, first-out basis. The pre-
9 ceding sentence shall not apply if the taxpayer
10 has in effect an election to use an average cost
11 basis method for such underlying investment.

12 “(C) BUILT-IN LOSS.—For purposes of
13 this section, the term ‘built-in loss’ means, with
14 respect to any derivative or underlying invest-
15 ment in an investment hedging unit, any loss
16 which would have been recognized and taken
17 into account under subsection (a) if the deriva-
18 tive were terminated or transferred, or the un-
19 derlying investment were sold or exchanged, at
20 its fair market value as of the later of the time
21 that the investment hedging unit was estab-
22 lished or the time the derivative or the under-
23 lying investment was first treated as part of the
24 investment hedging unit.

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 obligations or rights 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 are 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 of a
3 taxpayer with respect to which an election
4 is in effect under section 492(b), the close
5 of each business day, and

6 “(ii) an investment hedging unit of
7 any other taxpayer, the close of any tax-
8 able year if the applicable hedging period
9 with respect to such unit includes such
10 close.

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

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

21 “(1) IN GENERAL.—Except as provided in regu-
22 lations prescribed by the Secretary, in the case of a
23 payment pursuant to a derivative (other than an op-
24 tion)—

1 “(A) any item of income, deduction, gain,
2 or loss with respect to the payment shall be
3 taken into account for purposes of this title at
4 the time of the payment, and

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

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

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

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

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

21 “(e) HOLDING PERIOD OF UNDERLYING INVEST-
22 MENTS.—For purposes of section 1222, in the case of any
23 underlying investment which is part of an investment
24 hedging unit, the holding period for such investment shall
25 not include any period—

1 “(1) during which the underlying investment is
2 part of such unit, or

3 “(2) before the date on which the underlying in-
4 vestment became part of such unit.

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

8 “(1) a financial statement which is certified as
9 being prepared in accordance with generally accept-
10 ed accounting principles and which is—

11 “(A) a 10-K (or successor form), or annual
12 statement to shareholders, required to be filed
13 by the taxpayer with the United States Securi-
14 ties and Exchange Commission,

15 “(B) an audited financial statement of the
16 taxpayer which is used for—

17 “(i) credit purposes,

18 “(ii) reporting to shareholders, part-
19 ners, or other proprietors, or to bene-
20 ficiaries, or

21 “(iii) any other substantial nontax
22 purpose,

23 but only if there is no statement of the taxpayer
24 described in subparagraph (A), or

1 “(C) filed by the taxpayer with any other
2 Federal agency for purposes other than Federal
3 tax purposes, but only if there is no statement
4 of the taxpayer described in subparagraph (A)
5 or (B),

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) such investment hedging unit shall at
7 any time during the applicable hedging period
8 consist of the following held by the taxpayer at
9 such time:

10 “(i) Each derivative with respect to
11 the underlying investment which by itself,
12 or in combination with 1 or more other de-
13 rivatives, has a delta with respect to any
14 portion of the underlying investment which
15 is within the range beginning with minus
16 0.7 and ending with minus 1.0.

17 “(ii) The portions of the underlying
18 investment described in clause (i) with re-
19 spect to which the derivatives have the
20 delta described in clause (i).

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

1 “(A) beginning with the first time (after a
2 period which is not an applicable hedging pe-
3 riod) the taxpayer holds 1 or more of the de-
4 rivatives with respect to the underlying invest-
5 ment, and 1 or more portions of the underlying
6 investment, which are described in paragraph
7 (1)(B), and

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

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

12 “(1) IN GENERAL.—A taxpayer may elect with
13 respect to any underlying investment to treat for
14 purposes of this part all derivatives with respect to
15 such underlying investment, and all of such under-
16 lying investment, as part of an investment hedging
17 unit.

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

20 “(A) shall apply to all derivatives with re-
21 spect to the underlying investment, and all of
22 the underlying investment, held at any time
23 after the election is made (including during any
24 period such derivatives or underlying invest-
25 ment are not held simultaneously), and

1 “(B) shall be irrevocable.

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

4 “(A) IN GENERAL.—If a taxpayer—

5 “(i) does not have an election in effect
6 under paragraph (1) with respect to an un-
7 derlying investment, and

8 “(ii) fails to meet the requirements of
9 subsection (c) for testing and identifying
10 derivatives with respect to the underlying
11 investment,

12 the taxpayer shall be treated as having made
13 the election under paragraph (1).

14 “(B) TREATMENT OF ELECTION.—For
15 purposes of paragraph (2), a deemed election
16 under this paragraph—

17 “(i) shall be treated as made as of the
18 first time the taxpayer fails to meet the re-
19 quirements of subsection (c) with respect
20 to the underlying investment, and

21 “(ii) notwithstanding paragraph
22 (2)(B), may be revoked with the consent of
23 the Secretary.

24 “(c) DEFINITIONS AND RULES RELATING TO TAX-
25 PAYERS IDENTIFYING INVESTMENT HEDGING UNITS.—In

1 the case of a taxpayer with respect to which an election
2 is not in effect under subsection (b) with respect to an
3 underlying investment—

4 “(1) IN GENERAL.—The taxpayer shall, at the
5 times described in paragraph (3), test the derivatives
6 with respect to the underlying investment and make
7 the identifications described in paragraph (2).

8 “(2) IDENTIFICATION.—

9 “(A) IN GENERAL.—The taxpayer shall
10 identify the following with respect to an under-
11 lying investment:

12 “(i) Each derivative described in sub-
13 section (a)(1)(B)(i).

14 “(ii) The portions of the underlying
15 investment described in subsection
16 (a)(1)(B)(ii).

17 “(B) DERIVATIVES AND UNDERLYING IN-
18 VESTMENT NOT PART OF HEDGING UNIT.—A
19 taxpayer shall identify the derivatives with re-
20 spect to an underlying investment, and the por-
21 tions of the underlying investment, which are
22 not required to be identified under subpara-
23 graph (A).

24 “(C) PORTION MAY INCLUDE ALL OF UN-
25 DERLYING INVESTMENT.—For purposes of this

1 part, the term ‘portion’ with respect to any un-
2 derlying investment identified may include all of
3 the underlying investment.

4 “(3) TIMES IDENTIFICATIONS REQUIRED TO BE
5 MADE.—

6 “(A) IN GENERAL.—The taxpayer shall
7 test and make the identifications required
8 under this subsection at the following times
9 during any continuous period the taxpayer si-
10 multaneously holds 1 or more derivatives with
11 respect to an underlying investment and 1 or
12 more portions of the underlying investment:

13 “(i) The beginning of the period.

14 “(ii) Immediately after the taxpayer
15 (during such period)—

16 “(I) enters into another deriva-
17 tive with respect to the underlying in-
18 vestment or acquires an additional
19 amount of such underlying invest-
20 ment, or

21 “(II) terminates or transfers 1 or
22 more derivatives with respect to the
23 underlying investment or sells or ex-
24 changes any portion of the underlying
25 investment, except that no testing and

1 identification shall be required under
2 this subclause with respect to any
3 such transaction if the taxpayer does
4 not have an investment hedging unit
5 with respect to the underlying invest-
6 ment immediately before such trans-
7 action.

8 “(iii) Such other times during such
9 period as the Secretary may prescribe by
10 regulations or other guidance.

11 “(B) NO OTHER TIMES FOR TESTING.—
12 Except as provided by the Secretary, there shall
13 not be taken into account for purposes of this
14 part any testing and identification done by the
15 taxpayer with respect to an underlying invest-
16 ment at a time other than the times required
17 under subparagraph (A).

18 “(4) MANNER.—A taxpayer shall be treated as
19 timely making the identifications required under this
20 subsection if derivatives with respect to, and por-
21 tions of, an underlying investments are clearly iden-
22 tified as part of (or as not part of) the investment
23 hedging unit for purposes of this paragraph before
24 the close of the day on which the identification is re-

1 quired (or such other time as the Secretary by regu-
2 lations or other guidance may prescribe).

3 “(5) TREATMENT OF INCORRECT IDENTIFICA-
4 TION OF HEDGING TRANSACTIONS.—The Secretary
5 shall prescribe regulations to properly characterize
6 any income, gain, expense, or loss arising from any
7 derivative or underlying investment which is incor-
8 rectly identified under paragraph (2) as being part
9 of, or not being part of, an investment hedging unit.

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

11 “(1) IN GENERAL.—The term ‘delta’ means,
12 with respect to any derivative and underlying invest-
13 ment, the ratio of the expected change in the fair
14 market value of the derivative to any change in the
15 fair market value of the underlying investment.

16 “(2) METHOD OF DETERMINATION.—The delta
17 with respect to any derivative with respect to an un-
18 derlying investment (or any combination of such de-
19 rivatives) shall be determined—

20 “(A) in a commercially reasonable manner,
21 and

22 “(B) except as provided by the Secretary,
23 in a manner which is consistent with the man-
24 ner used by the taxpayer or the taxpayer’s

1 broker for purposes of an applicable financial
2 statement.

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

8 “(4) MULTIPLE UNDERLYING INVESTMENTS.—
9 If the value of a derivative is determined by ref-
10 erence to more than 1 underlying investment, the
11 delta shall be determined separately with respect to
12 each underlying investment.

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 is determined either di-
25 rectly or indirectly.

1 “(B) COORDINATION WITH SECTION 475.—

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

11 “(2) ESTABLISHMENT OF INVESTMENT HEDG-
12 ING UNIT.—A taxpayer shall be treated as having
13 established an investment hedging unit with respect
14 to an underlying investment—

15 “(A) in the case of a taxpayer with an
16 election in effect under subsection (b) with re-
17 spect to the underlying investment, as of the
18 date the election takes effect, and

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

22 “(3) RELATED PARTIES, ETC.—For purposes of
23 this section—

24 “(A) ATTRIBUTION BETWEEN RELATED
25 PERSONS.—

1 “(i) IN GENERAL.—Any derivative or
2 underlying investment held by a related
3 person with respect to the taxpayer shall
4 be treated as held by the taxpayer.

5 “(ii) RELATED PERSON.—The term
6 ‘related person’ has the meaning given
7 such term by section 1092(d)(4)(B).

8 “(B) CERTAIN FLOWTHROUGH ENTI-
9 TIES.—If part or all of the income, gain, loss,
10 or expense with respect to a derivative or un-
11 derlying investment held by a partnership,
12 trust, or other entity would properly be taken
13 into account for purposes of this chapter by the
14 taxpayer, then, except to the extent otherwise
15 provided in regulations, such derivative or in-
16 vestment shall be treated as held by the tax-
17 payer.

18 “(f) REGULATIONS.—The Secretary shall prescribe
19 such regulations as may be appropriate to carry out this
20 section, including regulations which require in appropriate
21 cases a taxpayer to bifurcate derivatives described in sub-
22 section (d)(4) for purposes of applying this part.

23 **“SEC. 493. DERIVATIVE DEFINED.**

24 “(a) IN GENERAL.—For purposes of this part, except
25 as otherwise provided in this section, the term ‘derivative’

1 means any contract (including any option, forward con-
2 tract, futures contract, short position, swap, or similar
3 contract) the value of which, or any payment or other
4 transfer with respect to which, is (directly or indirectly)
5 determined by reference to one or more of the following:

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

7 “(2) Any partnership or beneficial ownership
8 interest in a partnership or trust.

9 “(3) Any evidence of indebtedness.

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

12 “(5) Any commodity which is actively traded
13 (within the meaning of section 1092(d)(1)).

14 “(6) Any currency.

15 “(7) Any rate, price, amount, index, formula, or
16 algorithm.

17 “(8) Any other item as the Secretary may pre-
18 scribe.

19 Such term shall not include any item described in para-
20 graphs (1) through (8).

21 “(b) EXCEPTIONS.—

22 “(1) CERTAIN REAL PROPERTY.—

23 “(A) IN GENERAL.—For purposes of this
24 part, the term ‘derivative’ shall not include any
25 contract with respect to interests in real prop-

1 erty (as defined in section 856(c)(5)(C)) if such
2 contract requires physical delivery of such real
3 property.

4 “(B) OPTIONS TO SETTLE IN CASH.—

5 “(i) IN GENERAL.—For purposes of
6 subparagraph (A), a contract which pro-
7 vides for an option of cash settlement shall
8 not be treated as requiring physical deliv-
9 ery of real property unless the option is—

10 “(I) not exercisable uncondition-
11 ally, and

12 “(II) exercisable only in unusual
13 and exceptional circumstances.

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

20 “(2) HEDGING TRANSACTIONS.—

21 “(A) IN GENERAL.—For purposes of this
22 part, the term ‘derivative’ shall not include any
23 contract which is part of a hedging transaction
24 (as defined in section 1221(b)).

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

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

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

17 “(5) INSURANCE CONTRACTS, ANNUITIES, AND
18 ENDOWMENTS.—For purposes of this part, the term
19 ‘derivative’ shall not include any insurance, annuity,
20 or endowment contract issued by an insurance com-
21 pany to which subchapter L applies (or issued by
22 any foreign corporation to which such subchapter
23 would apply if such foreign corporation were a do-
24 mestic corporation).

1 “(6) DERIVATIVES WITH RESPECT TO STOCK
2 OF MEMBERS OF SAME WORLDWIDE AFFILIATED
3 GROUP.—For purposes of this part, the term ‘deriv-
4 ative’ shall not include any derivative (determined
5 without regard to this paragraph) with respect to
6 stock issued by any member of the same worldwide
7 affiliated group (as defined in section 864(f)) in
8 which the taxpayer is a member.

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

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

16 “(B) such commodity is used (and is used
17 in quantities with respect to which such deriva-
18 tive relates) in the normal course of the tax-
19 payer’s trade or business (or, in the case of an
20 individual, for personal consumption).

21 “(c) CONTRACTS WITH EMBEDDED DERIVATIVE
22 COMPONENTS.—

23 “(1) IN GENERAL.—If a contract has derivative
24 and nonderivative components, then each derivative
25 component shall be treated as a derivative for pur-

1 poses of this part. If the derivative component can-
2 not be separately valued, then the entire contract
3 shall be treated as a derivative for purposes of this
4 part.

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

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

12 “(B) payments with respect to such debt
13 instrument are determined by reference to the
14 value of a nonfunctional currency (as so de-
15 fined).

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

1 **SEC. 3. COORDINATION OF NEW RULES WITH EXISTING**
2 **RULES.**

3 (a) COORDINATION WITH RULES FOR DEALERS AND
4 TRADERS.—

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

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

9 (B) by striking subparagraphs (D) and (E)
10 and by redesignating subparagraph (F) as sub-
11 paragraph (D),

12 (C) by striking “subparagraph (A), (B),
13 (C), (D), or (E)” in subparagraph (D)(i), as so
14 redesignated, and inserting “subparagraph (A),
15 (B), or (C)”, and

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

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

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

23 (B) by striking subparagraphs (B) and (C)
24 and by redesignating subparagraph (D) as sub-
25 paragraph (B), and

1 (C) by striking “subparagraph (A), (B) or
2 (C)” in subparagraph (B)(i), as so redesign-
3 nated, and inserting “subparagraph (A)”.

4 (3) CONFORMING AMENDMENTS.—

5 (A) Section 475(b) is amended by striking
6 paragraph (4).

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

8 (i) by striking “subsection
9 (c)(2)(F)(iii)” and inserting “subsection
10 (c)(2)(D)(iii)”, and

11 (ii) by striking “subsection (c)(2)(F)”
12 and inserting “subsection (c)(2)(D)”.

13 (C) Section 475(f)(1)(D) is amended by
14 striking “subsections (b)(4) and (d)” and in-
15 sserting “subsection (d)”.

16 (b) COORDINATION WITH STRADDLE RULES.—

17 (1) IN GENERAL.—Section 1092(e) is amended
18 to read as follows:

19 “(e) EXCEPTION FOR HEDGING TRANSACTIONS AND
20 INVESTMENT HEDGING UNITS.—This section shall not
21 apply in the case of—

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

24 “(2) any investment hedging unit (as defined in
25 section 492).”.

1 (2) CONFORMING AMENDMENTS.—

2 (A) Section 263(g)(3) is amended to read
3 as follows:

4 “(3) EXCEPTION FOR HEDGING TRANSACTIONS
5 AND INVESTMENT HEDGING UNITS.—This sub-
6 section shall not apply in the case of—

7 “(A) any hedging transaction (as defined
8 in section 1221(b)), and

9 “(B) any investment hedging unit (as de-
10 fined in section 492).”.

11 (B) Section 1092(b) is amended—

12 (i) by striking paragraph (2), and

13 (ii) by striking all that precedes “The
14 Secretary shall” and inserting the fol-
15 lowing:

16 “(b) REGULATIONS.—The Secretary shall”.

17 (C) Section 1092(e) is amended by striking
18 paragraph (4).

19 (D) Section 1092 is amended by striking
20 subsection (f) and by redesignating subsection
21 (g) as subsection (f).

22 (c) DEBT INSTRUMENTS HELD BY INSURANCE COM-
23 PANIES.—

24 (1) IN GENERAL.—Subsection (a) of section
25 1221 is amended by striking “or” at the end of

1 paragraph (7), by striking the period at the end of
2 paragraph (8) and inserting “; or”, and by adding
3 at the end the following:

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

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

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

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

17 “(i) which is subject to tax under sec-
18 tion 801(a)(1) or section 831(a),

19 “(ii) with respect to which sections
20 831(b), 835, 842, and 847 do not apply,
21 and

22 “(iii) which is not treated as a stock
23 insurance company solely by reason of sec-
24 tion 833(a)(1).

1 “(B) PERMANENT TREATMENT BY COM-
2 PANY AS ORDINARY ASSET.—If an asset is
3 treated as an asset described in subsection (a)
4 (9) with respect to any applicable insurance
5 company for any taxable year, such asset shall
6 be treated as so described during any subse-
7 quent taxable year such asset is held by such
8 company.”.

9 (3) REGULATIONS.—Paragraph (4) of section
10 1221(b) is amended—

11 (A) by striking “The Secretary” and in-
12 serting:

13 “(A) RELATED PARTIES.—The Secretary”,
14 and

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

16 “(B) ASSETS OF INSURANCE COMPA-
17 NIES.—The Secretary shall prescribe such regu-
18 lations as may be necessary or appropriate to
19 carry out the purposes of subsection (a)(9), in-
20 cluding such regulations as may be necessary to
21 prevent the avoidance of Federal income tax
22 through the sale or exchange of assets described
23 in such subsection.”.

24 (4) EFFECTIVE DATE.—

1 (A) IN GENERAL.—The amendments made
2 by this subsection shall apply to any bond, de-
3 benture, note, or certificate or other evidence of
4 indebtedness held or acquired after the 90-day
5 period beginning with the date of the enactment
6 of this Act.

7 (B) TRANSITION RULE.—If a taxpayer has
8 a capital loss carryover to any taxable year of
9 the taxpayer beginning after the close of the
10 90-day period described in subparagraph (A),
11 the taxpayer shall, in addition to other short-
12 term capital gain of the taxpayer (if any), treat
13 as short-term capital gain (rather than as ordi-
14 nary income) an amount equal to the lesser
15 of—

16 (i) the net gain (if any) from sales or
17 exchanges during such taxable year of as-
18 sets to which section 1221(a)(9) of such
19 Code (as added by paragraph (1)) applies,
20 or

21 (ii) the capital loss carryovers to such
22 taxable year from taxable years beginning
23 before the close of such period.

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

2 (a) REPEAL OF CERTAIN OTHER SUPERCEDED
3 RULES FOR DETERMINING CAPITAL GAINS AND
4 LOSSES.—

5 (1) IN GENERAL.—Part IV of subchapter P of
6 chapter 1 is amended by striking sections 1233,
7 1234, 1234A, 1234B, 1236, 1256, 1258, 1259, and
8 1260 (and by striking the items relating to such sec-
9 tions in the table of sections for such part).

10 (2) CONFORMING AMENDMENTS RELATED TO
11 REPEAL OF SECTION 1233.—Section 1092(b) is
12 amended by inserting “(as in effect before their re-
13 peal)” after “section 1233”.

14 (3) CONFORMING AMENDMENTS RELATED TO
15 REPEAL OF SECTION 1234.—Section 6045(h)(2) is
16 amended—

17 (A) by striking “(as defined in section
18 1234(b)(2)(A))”, and

19 (B) by adding at the end the following:
20 “For purposes of the preceding sentence, the
21 term ‘closing transaction’ means any termi-
22 nation of the taxpayer’s obligation under an op-
23 tion in property other than through the exercise
24 or lapse of the option.”.

25 (4) CONFORMING AMENDMENTS RELATED TO
26 REPEAL OF SECTION 1236.—

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

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

6 (C) Section 1058 is amended—

7 (i) by striking “(as defined in section
8 1236(c))” in subsection (a), and

9 (ii) by redesignating subsection (c) as
10 subsection (d) and by inserting after sub-
11 section (b) the following new subsection:

12 “(c) SECURITIES.—For purposes of this section, the
13 term ‘security’ means any share of stock in any corpora-
14 tion, certificate of stock or interest in any corporation,
15 note, bond, debenture, or evidence of indebtedness, or any
16 evidence of an interest in or right to subscribe to or pur-
17 chase any of the foregoing.”.

18 (5) CONFORMING AMENDMENTS RELATED TO
19 REPEAL OF SECTION 1256.—

20 (A)(i) Section 461(i)(3)(B) is amended to
21 read as follows:

22 “(B) any partnership or other entity (other
23 than a corporation which is not an S corpora-
24 tion) if more than 35 percent of the losses of
25 such entity during the taxable year are allocable

1 to limited partners or limited entrepreneurs
2 (within the meaning of subsection (k)(4)),
3 and”.

4 (ii) Section 461 is amended—

5 (I) by redesignating the second
6 subsection (j) (relating to farming
7 syndicate defined) as subsection (k),
8 and

9 (II) by striking “subsection (j)”
10 in subsection (i)(4) and inserting
11 “subsection (k)”.

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

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

17 (D) Section 1092(a)(3)(C)(ii)(II) is
18 amended by striking “section 1256(e)” and in-
19 serting “section 1221(b)”.

20 (E) Section 1092(d) is amended by strik-
21 ing paragraphs (5) and (6) and by redesign-
22 ating paragraphs (7) and (8) as paragraphs
23 (5) and (6), respectively.

24 (F) Section 1212 is amended by striking
25 subsection (c).

1 (G) Section 1223 is amended by striking
2 paragraphs (7) and (14).

3 (H) Section 1281(b)(1)(E) is amended to
4 read as follows:

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

8 (I) Section 1402 is amended by striking
9 subsection (i).

10 (J) Section 4982(e)(6)(B) is amended by
11 striking “sections 1256 and 1296” and insert-
12 ing “sections 491 and 1296”.

13 (6) CONFORMING AMENDMENTS RELATED TO
14 REPEAL OF SECTION 1259.—Section 475(f)(1) is
15 amended by striking subparagraph (C) and by red-
16 ignating subparagraph (D) as subparagraph (C).

17 (b) OTHER CONFORMING AMENDMENTS.—

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

20 “(V) any derivative (as defined in
21 section 493),”.

22 (2) Section 856(n)(4) is amended by inserting
23 “or derivatives (as defined in section 493)” after
24 “securities (as defined in section 475(c)(2))”.

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

4 (4) Section 988(d)(1) is amended—

5 (A) by striking “or 1256” and inserting
6 “or 491”, and

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

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

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

15 “(1) any derivative (as defined in section 493),
16 or

17 “(2) any underlying investment (as defined in
18 section 492(e)(1)) which, at the time of the sale or
19 other disposition, is part of an investment hedging
20 unit (as defined in section 492).”.

21 (6)(A) Section 1221(a)(6) is amended to read
22 as follows:

23 “(6) any—

24 “(A) derivative (as defined in section 493),

25 or

1 “(B) any underlying investment (as de-
2 fined in section 492(e)(1)) which is part of an
3 investment hedging unit (as defined in section
4 492),”.

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

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

10 “(i) SECURITY.—The term ‘security’
11 means any security described in section
12 475(e)(2) (without regard to subparagraph
13 (D)(iii) thereof) and any derivative with re-
14 spect to such a security (within the mean-
15 ing of section 493).

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

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

 “PART IV. DERIVATIVES”.

1 **SEC. 5. EFFECTIVE DATES.**

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

3 (1) the amendments made by section 2 shall
4 apply to taxable events occurring after the 90-day
5 period beginning with the date of the enactment of
6 this Act, in taxable years ending after the last day
7 of such period, and

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

11 (b) IDENTIFICATION REQUIREMENTS.—If, as of the
12 close of the 90-day period described in subsection (a)(1),
13 a taxpayer simultaneously holds 1 or more derivatives with
14 respect to an underlying investment and the underlying
15 investment—

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

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

24 (c) DEFINITIONS.—For purposes of this section, any
25 term used in this section which is also used in part IV

- 1 of subchapter E of chapter 1 of such Code (as so added)
- 2 shall have the same meaning as when used in such part.