

Securities transactions

454.1 Arbitrage operations. The purchase of convertible bonds, which are down in price in relation to the price of the common stock into which they are convertible, and the simultaneous sale of equivalent stock, is an arbitrage operation and constitutes a short sale. §29.117-10. (Sec. 117, '39 Code; Sec. 1233, '86 Code.)

Rev. Rul. 154, 1953-2 C.B. 173.

454.2 Book-entry Federal securities; dealers. A dealer in securities may transfer Federal securities properly held in inventory to a book-entry system maintained by a Federal Reserve Bank. Such dealer is not subject to the property identification provisions of reg. 1.1012-1 with respect to such securities, but must comply with the inventory provisions of reg. 1.471-5. Amplified by Rev. Rul. 73-37. §§1.471-5, 1.1012-1. (Secs. 471, 1012; '86 Code.)

Rev. Rul. 71-15, 1971-1 C.B. 149.

454.3 Book-entry Federal securities; identification. A dealer in securities who identifies a particular book-entry Treasury security held for investment by reference to an assigned lot number at the time of purchase satisfies the requirements of reg. 1.1236-1(d)(1)(ii). Rev. Ruls. 71-15 and 71-21 amplified. §§1.1012-1, 1.1236-1. (Secs. 1012, 1236; '86 Code.)

Rev. Rul. 73-37, 1973-1 C.B. 374.

454.4 Book-entry Federal securities; record requirements. A procedure that is consistent with the tax record requirements of reg. 1.1012-1(c)(7) when Treasury and certain other securities are transferred to a bank that has an account in the book-entry system of a Federal Reserve Bank. Amplified by Rev. Rul. 73-37. §1.1012-1. (Sec. 1012, '86 Code.)

Rev. Rul. 71-21, 1971-1 C.B. 221.

454.5 Book-entry Federal securities; serially-numbered advice of transaction. Reference to the serially-numbered advice of transaction furnished by a Federal Reserve Bank is adequate identification of book-entry Treasury securities to establish cost and holding period of securities sold, transferred or withdrawn. Amplified to be made applicable to transactions to which the book-entry Treasury security rules have been extended by the amendment of reg. 1.1012-1(c)(7)(ii)(a). §§1.1012-1, 1.1236-1. (Secs. 1012, 1236; '86 Code.)

Rev. Rul. 67-419, 1967-2 C.B. 265; Rev. Rul. 69-416, 1969-2 C.B. 159.

454.6 Book-entry Federal securities; U.S. Postal Service obligations. Obligations of the U.S. Postal Service qualify as "government securities" under section 851(b)(4) and 856(c)(5)(A) and "obligations of a corporation which is an instrumentality of the U.S." under section

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7701(a)(19)(C)(ii). Thus, investments therein by regulated investment companies, real estate investment trusts, and domestic building and loan associations will not affect their status. Also, investments by foreign central banks of issue may be treated as investments in obligations of an instrumentality under section 895. Such obligations also qualify as "other security of the U.S." used in reg. 1.1012-1(c)(7)(iii)(a)(1) in defining "book entry securities." §§1.851-2, 1.856-2, 1.895-1, 1.1012-1, 402.1-2 (Secs. 851, 856, 895; 1012, 7701; '86 Code.)

Rev. Rul. 71-537, 1971-2 C.B. 262.

454.7 Broker-dealer; order errors and security differences; treatment. The treatment of certain gains, losses, and expenses resulting from order errors or security differences incurred by a broker-dealer is explained. §§1.61-1, 1.162-1, 1.165-1, 1.451-1, 1.461-1, 1.1236-1. (Secs. 61, 162, 165, 451, 461, 1236; '86 Code.)

Rev. Rul. 79-80, 1979-1 C.B. 86.

454.8 Brokers; information returns. Information returns are not required of a broker in any instance in which the broker receives the instructions of the seller from a registered securities or commodities dealer or a financial institution. §1.6045-1. (Secs. 3452, 6045; '86 Code.)

Rev. Rul. 83-123, 1983-2 C.B. 221.

454.9 Compensation to "owners"; subordinated accounts. Compensation paid by a brokerage firm to "owners," with respect to cash and securities subject to a "Subordination Agreement," is ordinary income to the owners and is deductible by the firm as ordinary and necessary business expenses. §§1.61-1, 1.162-1. (Secs. 61, 162; '86 Code.)

Rev. Rul. 69-455, 1969-2 C.B. 9.

454.10 Discounted debentures exchanged for common and preferred stock in recapitalization. No amount is includible in the income of debenture holders, under section 1232(a)(2)(A) or (a)(2)(B), as a result of the exchange of their debentures for common or preferred stock in a recapitalization qualifying as a reorganization under section 368(a)(1)(E). §1.1232-1. (Sec. 1232; '86 Code.)

Rev. Rul. 75-39, 1975-1 C.B. 272.

454.11 Extension of time for identification. The Service extends time for identification of securities for purposes of section 475(b)(2) until October 31, 1993.

Notice 93-45, 1993-2 C.B. 334.

454.12 Guidance under section 475 mark-to-market rules. The Service provides guidance concerning the definition of a dealer in securities, how to identify securities and how to compute a net section 481(e) adjustment. (Sec. 475; '86 Code.)

Rev. Rul. 93-76, 1993-2 C.B. 235.

454.13 Insider profits. Insider profits recovered by a corporation from one of its directors and a shareholder pursuant to the provisions of the Securities Exchange Act of 1934 and the Investment Company Act of 1940 constitute taxable income to the corporations. §39.22(a)-1. (Sec. 22(a); '39 Code; Sec. 61; '86 Code.)

General American Investors Co., 348 U.S. 434, Ct. D. 1784, 1955-1 C.B. 210.

454.14 Insider profits; business expense deduction. A senior partner in an investment banking company which dealt in shares of stock of a corporation in which he was a shareholder-director, reported his share of gross profits realized from such transactions as ordinary income. It later appeared that he might be liable to the corporation for "insider profits". Without admitting a violation of S.E.C. rules and without an official or judicial determination of a violation, he paid the cor-

poration the maximum amount it could have recovered. *Held*, the payments were deductible as business expenses to protect the partner's business reputation and to avoid the expense of litigation. (Sec. 23(a); '39 Code; Sec. 162; '86 Code.)

Laurence M. Marks, 27 T.C. 464, Acq., 1966-1 C.B. 2.

454.15 Insider profits; business expense deduction. Payments made to a corporation by a corporate officer, and by a director, for an apparent violation of section 16(b) of the Securities and Exchange Act of 1934 involving an insider's profit on a sale and subsequent purchase of the corporation's stock, were made to protect the taxpayers' business reputations and are deductible as ordinary and necessary business expenses, rather than as a capital loss or a business loss. (Sec. 162; '86 Code.)

James E. Anderson, 56 T.C. 1370, Nonacq., 1978-1 C.B. 2; Nathan Cummings, 60 T.C. 91, Nonacq., 1978-1 C.B. 2.

454.16 Involuntary conversions; sale of stock by trustee in bankruptcy. Stock that is sold by a trustee in bankruptcy while being held in a margin account by a bankrupt stock broker is not property taken and sold for public use, and is not an involuntary conversion under section 1033. §1.1033(a)-2. (Sec. 1033; '86 Code.)

Rev. Rul. 79-269, 1979-2 C.B. 297.

454.17 Loss; speculation in Treasury bonds. The taxpayer ordered but did not pay for maturing Treasury bonds he intended exchanging at a gain for newly issued higher priced bonds. The new bonds fell in price and the taxpayer was sued for payment. *Held*, the transaction was entered into for profit and the loss is deductible. (Sec. 165; '86 Code.)

Max Starr, 46 T.C. 450, Acq., 1967-1 C.B. 3.

454.18 Margined securities; sale by trustee of insolvent broker. The loss sustained from the sale of stock purchased on margin by an individual investor and sold by the trustee of the insolvent brokerage house holding the stock is a deductible capital loss. §1.165-1. (Sec. 165; '86 Code.)

Rev. Rul. 74-293, 1974-1 C.B. 54.

454.19 Notes; maturity date extended; redemption deferral agreement. The mere extension of the maturity date of certain outstanding notes, accompanied by the agreement of certain noteholders not to resort to the underlying securities until all other noteholders have been paid, does not constitute an exchange of securities or result in a taxable transaction. G.C.M. 22056 superseded. §1.1002-1. (Sec. 1002; '86 Code.)

Rev. Rul. 73-160, 1973-1 C.B. 365.

454.20 Options; "call"; short sales. Taxpayer purchased a "call" on 100 shares of stock. He made two short sales of the stock subject to the call and covered those sales by purchasing equal shares. After six months he sold the "call" option. *Held*, the "call" and the stock subject to call are not substantially identical property within the meaning of section 1233. If the stock subject to call would have been a capital asset in the taxpayer's hands, gain or loss on sale of the call constitutes a long-term gain or loss. §§1.1233-1, 1.1234-1. (Secs. 1233, 1234; '86 Code.)

Rev. Rul. 58-384, 1958-2 C.B. 410.

454.21 Options; "put" and "call" transactions. Where a "put" option is exercised, the premium received by the optioner constitutes an offset against the option price in determining the (net) cost basis of the securities purchased, for subsequent gain or loss purposes. Where a "call" is exercised, the premium received is includible, with the option price, in the total amount received by the optioner to determine gain or loss on their sale. These rules do not apply to option dealers and option brokers. Clarified to indicate that option

forms are usually signed by the dealer. §§39.117(g)-1, 1.1234-1. (Sec. 117(g); '39 Code; Secs. 61, 1234; '86 Code.)

Rev. Rul. 58-234, 1958-1 C.B. 279; Rev. Rul. 68-151, 1968-1 C.B. 363.

454.22 Pilot operation. Where investment securities of a brokerage firm are deposited in accordance with a securities pilot operation with a bank as transfer agent to be held in the name of a nominee partnership, together with similar securities of that firm and other participating firms held for sale to customers in the ordinary course of business, such securities do not qualify as clearly identifiable investment securities. Accordingly, any gain on the sale of such securities is taxed as ordinary income. Modified by Rev. Rul. 64-160. §1.1236-1. (Sec. 1236; '86 Code.)

Rev. Rul. 59-332, 1959-2 C.B. 190.

454.23 Short sales; delivery by decedent's estate to close sale; basis. A short sale of stock entered into by a decedent during his lifetime while holding identical stock previously purchased was not consummated until the decedent's estate closed out the transaction by delivering the decedent's stock to a broker for immediate application to the short sale. The basis of the stock held on the date of the decedent's death is the fair market value of the stock on such date or the alternate valuation date as provided by section 2032 of the Code. §1.1233-1. (Sec. 1233; '86 Code.)

Rev. Rul. 73-524, 1973-2 C.B. 307.

454.24 Short sales; dividend exclusion. An amount with respect to stock borrowed to cover a short sale, equal to a cash dividend paid to a lender of stock by the "short seller", is not a dividend for which a lender is entitled an exclusion under section 116. The purchaser in the short sale transaction, the real owner of the stock, is entitled to the partial exclusion with respect to cash dividends received on such stock. §§1.1161, 1.316-1. (Secs. 116, 316; '86 Code.)

Rev. Rul. 60-177, 1960-1 C.B. 9.

454.25 Short sales; dividends on borrowed stock. Amounts paid or incurred by investors or traders in securities with respect to ordinary cash dividends on borrowed stock to cover short sales are deductible expenses and not proper adjustments to the basis of the stock purchased to close the short sale. S.M. 4218 modified. §§1.162-1, 1.212-1, 1.1016-2. (Secs. 162, 212, 1016; '86 Code.)

Rev. Rul. 62-42, 1962-1 C.B. 133.

454.26 Short sales; loan premium and dividend payments; stock on liquidating dividend payments. Loan premiums paid by an investor in securities in the acquisition of stock borrowed to cover short sales and amounts equal to ordinary cash dividends paid with respect to such stock are deductible under section 212. However, amounts paid by investors or traders with respect to nontaxable stock dividends or liquidating dividends on such borrowed stock are capital expenditures and are not deductible. I.T. 3989 and Rev. Rul. 60-359 superseded. §§1.212-1, 1.263(a)-1. (Secs. 212, 263; '86 Code.)

Rev. Rul. 72-521, 1972-2 C.B. 178.

454.27 Short sales; long position in same securities. A transaction is a valid short sale which will not be reconsidered to be consummated until the date that securities are delivered to close the sale where borrowed securities are delivered to the purchaser by the broker who is prohibited, under a special loan agreement, from borrowing identical securities from the seller's accounts for delivery to the purchaser. §1.1233-1. (Sec. 1233; '86 Code.)

Rev. Rul. 72-478, 1972-2 C.B. 487.

454.28 Short sales; long position in same securities; regulated investment company. For purposes of section 851(b)(3), a regulated invest-

ment company selling stock short that it had held for four months and closing the sale at a gain one month later by delivering the stock held is considered as delivering the stock not held for less than three months. If the sale was closed by delivering the stock held and identical stock was purchased after the short sale, while the sale was still open, a similar result would obtain and the purchased stock would have a holding period that begins on the closing date of the short sale. However, closing the sale by delivering identical stock purchased after the short sale is considered as delivering stock held for less than three months and the holding period of the initial stock held begins on the closing date of the short sale. §§1.851-2, 1.1233-1. (Secs. 851, 1233; '86 Code.)
Rev. Rul. 74-434, 1976-2 C.B. 195.

454.29 Short sales; option stock; transactions during three-year holding period. During the three-year holding period for stock obtained through the exercise of a qualified stock option, a short-sale transaction involving identical borrowed stock constitutes a disposition of the option stock. This ruling applies to short sale transactions entered into after February 20, 1973. §§1.425-1, 301.7805-1. (Secs. 425, 7805; '86 Code.)
Rev. Rul. 73-92, 1973-1 C.B. 208.

454.30 Short sales; small business investment company stock. A loss incurred on the closing of a short sale of small business investment company stock with subsequently purchased stock acquired solely to close the short sale is not deductible as an ordinary loss under section 1242. The nature of the loss is determined under section 1233, dealing with gains and losses from short sales. §§1.1233-1, 1.1242-1. (Secs. 1233, 1242; '86 Code.)
Rev. Rul. 63-65, 1963-1 C.B. 142.

454.31 Short sales; substantially identical stock. Where a taxpayer sells short "when issued" common stock of a corporation in which he holds, or later acquires preferred stock which may be used to obtain stock identical to that sold short, the conversion of the preferred stock prior to the closing of the short sale does not constitute, at that time, the acquisition of substantially identical stock. Any gain realized will not be considered gain realized upon the sale or exchange of a capital asset held not more than six months, unless the preferred stock and the "when issued" common stock were substantially identical at the time of the short sale or at the time of the acquisition of the preferred stock where it is acquired after the short sale. §§1.1223-1, 1.1233-1. (Sec. 1223, 1233; '86 Code.)
Rev. Rul. 62-153, 1962-2 C.B. 186.

454.32 Stock; identification of commingled securities; dealers. Dealers in securities, participating in approved methods of clearing stock transactions, may meet the stock identification requirements of reg. 1.1236-1(d)(1)(ii) without indicating the individual certificate number of each security in their records provided they comply with prescribed instructions. Modified to include any security as defined in section 1236(c) and to provide that the nominee is whose name the securities are held may be the nominee of either the clearing company or the participating securities dealer. Rev. Rul. 59-332, relating to securities pilot operations, modified. §1.1236-1. (Sec. 1236, '86 Code.)

Rev. Rul. 64-160, 1964-1 (Part 1) C.B. 306;
Rev. Rul. 76-489, 1976-2 C.B. 250.

454.33 Stock; identification of securities; investment holding company. An investment holding company trading in, and holding for investment, marketable stocks and other securities, leaves its portfolio of marketable stock in the custody of a broker who is authorized to sell such stock. The broker advises the company of a sale,

then, prior to settlement date (four business days after the trade date) the company notifies the broker which specific stock it wishes to be considered delivered. Confirmation is made by the broker within five days of settlement. This procedure is considered sufficient identification of the securities. §1.1012-1. (Sec. 1012, '86 Code.)
Rev. Rul. 67-436, 1967-2 C.B. 266.

454.34 Stock; identification of shares. Where shares of stock, which were purchased in different lots on different dates and left in the custody of a broker, are ordered to be sold, an adequate identification is made if the owner (1) specifies to the broker in writing the sequence in which he desires to sell the shares; (2) identifies the shares to be sold either by purchase date, cost, or both; and (3) receives a written confirmation of the specification from the broker. The average price per share may not be used as the basis in computing gains or losses on the sale. §1.1012-1. (Sec. 1012, '86 Code.)

Rev. Rul. 61-97, 1961-1 C.B. 394.

454.35 Straddle; premiums. Guidelines have been established for allocating the premium received by writers of "straddle" contracts involving corporate stock. The Service will accept an allocation in which 55 percent of the premium is allocated to the "call" option and 45 percent of the premium to the "put" option, provided that the option writer uses this ratio in allocating premiums on all "straddle" contracts issued on or after January 26, 1965. If a taxpayer does not use this allocation method, then the allocation based on relative market value required by Rev. Rul. 65-31 must be used. §1.1234-1. (Sec. 1234, '86 Code.)

Rev. Proc. 65-29, 1965-2 C.B. 1023.

454.36 Yearend stock sales. When a cash basis taxpayer sells stock in one year and receives payment in the next year, if taxpayer elects out of the installment method, the taxpayer must include the gain from the sale in gross income for the year of sale. Rev. Rul. 72-381 is obsolete. (Sec. 453, '86 Code.)

Rev. Rul. 82-227, 1982-2 C.B. 89.