

Section 1259.—Constructive Sales Treatment for Appreciated Financial Positions

(Also § 1233; 26 CFR 1.1233–1.)

Constructive sales, short sales, transition rule. This ruling provides guidance on whether changes made to a margin ac-

count through which a short sale was effectuated will (1) cause the short sale to be deemed consummated under section 1.1233–1(a)(4) of the regulations, and (2) cause the short-against-the-box transaction to cease to be covered by the transition rule in the Taxpayer Relief Act of 1997.

ISSUES

(1) Will changes to the terms of a margin account through which a short sale was effectuated cause the short sale to be consummated for purposes of § 1.1233-1(a)(4) of the Income Tax Regulations?

(2) If a taxpayer's pre-June 9, 1997, appreciated financial position and short-against-the-box transaction are not taken into account for purposes of applying § 1259 of the Internal Revenue Code to post-June 8, 1997, transactions, as provided by the transition rule in § 1001(d)(2) of the Taxpayer Relief Act of 1997, 1997-4 (Vol. 1) C.B. 1, 121, will changes to the terms of the margin account through which the short sale was effectuated cause the transition rule to cease to apply?

FACTS

In January 1997, Taxpayer *TP* owned 100 shares of *XYZ* stock (the *XYZ* stock). *TP* established a securities trading account (the Margin Account) with Broker, who charged interest and fees with respect to the Margin Account. In May 1997, at a time when the *XYZ* stock was appreciated, *TP* effected a short sale (the Short Sale) of 100 shares of *XYZ* stock through Broker, who borrowed the 100 shares of *XYZ* stock to make delivery. Before September 4, 1997, *TP* clearly identified the *XYZ* stock and the Short Sale in its books and records as offsetting positions.

In January 2002, Broker and *TP* negotiated changes to the interest rates and fees associated with the Margin Account.

TP continues to hold the *XYZ* stock and has not delivered any other shares to Broker to close the Short Sale.

LAW

Section 1.1233-1(a)(1) provides that, for income tax purposes, a short sale is not deemed to be consummated until delivery of property to close the short sale. Pursuant to § 1.1233-1(a)(4), if a taxpayer makes a short sale through a broker and the broker borrows property to make the delivery on the short sale, the short sale is not deemed to be consummated until the ob-

ligation of the selling taxpayer that is created by the short sale is finally discharged by delivery of property to the broker to replace the property that the broker borrowed.

Section 1259(a)(1) provides that if there is a constructive sale of an appreciated financial position, the taxpayer shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale. Appreciated financial position is defined in § 1259(b)(1) as including a position with respect to stock if there would be gain were such position sold, assigned, or otherwise terminated at its fair market value. Pursuant to § 1259(c)(1)(A), a taxpayer is treated as having made a constructive sale of an appreciated financial position if the taxpayer enters into a short sale of the same or substantially identical property.

Under § 1001(d)(2) of the Taxpayer Relief Act of 1997 (the transition rule), if "before June 9, 1997, the taxpayer entered into any transaction which is a constructive sale of any appreciated financial position, and . . . before the close of the 30-day period beginning on the date of the enactment of this Act [August 5, 1997] or before such later date as may be specified by the Secretary of the Treasury, such transaction and position are clearly identified in the taxpayer's records as offsetting, such transaction and position shall not be taken into account in determining whether any other constructive sale after June 8, 1997, has occurred." The transition rule ceases to apply as of the date such transaction is closed or the taxpayer ceases to hold the position. § 1001(d)(2) of the Taxpayer Relief Act of 1997, 1997-4 (Vol. 1) C.B. 1, 121.

ANALYSIS

(1) Section 1233

At the time of the changes to the Margin Account, *TP* had not delivered stock to Broker to close the Short Sale, and no such stock was delivered in connection with the changes. The Short Sale, therefore, is not consummated for purposes of § 1.1233-1(a)(4).

(2) Section 1259 Transition Rule

In May 1997, when the *XYZ* stock was appreciated, *TP* entered into the Short Sale.

Thus, *TP* entered into a transaction that is described in § 1259(c)(1). Because the Short Sale was entered into before June 9, 1997, however, no gain was recognized under § 1259(a)(1).

Furthermore, before the close of the 30-day period beginning on August 5, 1997, *TP* clearly identified the *XYZ* stock and the Short Sale in its books and records as offsetting positions. Thus, the *XYZ* stock and the Short Sale fell within the transition rule, and, until *TP* either ceases to hold the *XYZ* stock or closes the Short Sale, neither the *XYZ* stock nor the Short Sale is taken into account in determining whether some new transaction has caused a constructive sale under § 1259(a)(1).

At the time of the changes to the Margin Account, *TP* continued to hold the *XYZ* stock and the Short Sale had not been consummated for purposes of § 1.1233-1(a)(4). Accordingly, the transition rule continues to apply to the Short Sale and the *XYZ* stock.

HOLDINGS

(1) Because the changes made to the terms of the Margin Account do not constitute a delivery of the *XYZ* stock, the changes do not cause the Short Sale to be consummated for purposes of § 1.1233-1(a)(4).

(2) Because the changes made to the terms of the Margin Account do not constitute a delivery of the *XYZ* stock, the changes do not cause the transition rule to cease to apply to either the Short Sale or the *XYZ* stock.

DRAFTING INFORMATION

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