

119TH CONGRESS  
2D SESSION

# S. 4331

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

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## IN THE SENATE OF THE UNITED STATES

APRIL 16 (legislative day, APRIL 14), 2026

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

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## 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.

“(B) CAPITAL LOSS CARRYOVERS.—If, for any taxable year during which such election is in effect with respect to such investment hedging unit, a taxpayer has a capital loss carryover to such taxable year from any taxable year preceding such taxable year, the taxpayer shall, in addition to other short-term capital gain of the taxpayer (if any), treat as short-term capital gain (rather than as ordinary income) an amount equal to the lesser of—

“(i) the net gain from such investment hedging unit (as determined under section 491(a)) during such taxable year, or

“(ii) the sum of—

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

“(II) the capital loss carryovers to such taxable year from any such 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 PLICABLE 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                   quirements 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

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 INDIVIDUALS FILING SEPARATELY AND LIVING  
2                   APART.—A husband and wife who—

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

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

7                   shall not be treated as married individuals.

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

18                  **“SEC. 493. DERIVATIVE DEFINED.**

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

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(c)(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

time and in such manner and form as the Secretary may prescribe—

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

“(ii) the amount of such unrecognized gain.

The Secretary may waive the requirement to report under this subparagraph with respect to any position if such reporting is not required to carry out the purposes of this section.

“(3) SPECIAL RULES FOR PHYSICALLY SETTLED POSITIONS.—For purposes of this subsection, if a taxpayer settles a position which is part of a straddle by delivering property to which the position relates (and such position, if terminated, would result in a realization of a loss), then such taxpayer shall be treated as if such taxpayer—

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

“(B) sold the property so delivered by the 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

90-day period described in subparagraph (A), the taxpayer shall, in addition to other short-term capital gain of the taxpayer (if any), treat as short-term capital gain (rather than as ordinary income) an amount equal to the lesser of—

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

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

(d) RICS ALLOWED NET OPERATING LOSS DEDUCTION.—

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

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

“(6) MODIFICATIONS RELATED TO RICS AND 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-

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

“(2) INCOME RECOGNITION ON CERTAIN FORWARD CONTRACTS.—

“(A) IN GENERAL.—If—

“(i) a corporation acquires its stock,  
and

“(ii) such acquisition is part of a plan  
(or series of related transactions) pursuant  
to which the corporation enters into a forward  
contract with respect to its stock,

such corporation shall include amounts in income as if the excess of the amount to be received under the forward contract over the fair market value of the stock as of the date the corporation entered into the forward contract were original issue discount on a debt instrument acquired on such date. The preceding sentence shall apply only to the extent that the amount of stock involved in the forward contract does not exceed the amount acquired as described in clause (i).

“(B) PLAN PRESUMED TO EXIST.—If a corporation enters into a forward contract with 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 redes-  
12          ignating 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.

○