MEMO# 14694

May 6, 2002

FINAL REGULATIONS ON TREATMENT OF QUALIFIED COVERED CALL OPTIONS UNDER TAX STRADDLE RULES

[14694] May 6, 2002 TO: TAX COMMITTEE No. 16-02 RE: FINAL REGULATIONS ON TREATMENT OF QUALIFIED COVERED CALL OPTIONS UNDER TAX STRADDLE RULES The Internal Revenue Service has adopted the attached final regulations which provide an exemption from the tax straddle rules for qualified covered call ("QCC") options, including equity options with flexible terms ("FLEX options") and certain over-the-counter options ("OTC options"). Among other adverse tax consequences of holding a tax straddle, realized losses on one position in a straddle must be deferred to the extent there is unrealized gain in any other position in the straddle. In general, the final regulations make the following modifications to the proposed regulations that were issued on January 18, 2001:1 • permit QCC treatment to apply to options with a term greater than one year, but not more than 33 months;2 • expand the list of parties with or through whom OTC options eligible for QCC treatment may be effected to include banks (in addition to registered broker- dealers and alternative trading systems); and • permit a registered broker-dealer (or bank) to act as principle or agent in connection with an OTC option transaction that is eligible for QCC treatment. The final regulations generally apply to QCC options entered into on or after July 29, 2002. Deanna J. Flores Associate Counsel Attachment (in .pdf format) 1 See Institute Memorandum to Tax Committee No. 5-01, dated February 13, 2001, for a description of the proposed regulations. 2 For options with a term greater than one year, taxpayers are required by the regulations to increase the strike price using a prescribed formula to account for the risk reduction potential of longer-term options.