

Treasury delays effective date of new temporary regulations addressing identified mixed straddles

October 28, 2013

In brief

On August 1, 2013, the IRS issued temporary Treasury regulations that prohibited taxpayers from using identified mixed straddles executed after August 1, 2013 as an investment strategy to recognize built-in capital gains in order to offset capital loss carryforwards. These temporary regulations applied to all identified mixed straddle transactions entered into after August 1, 2013. On October 25, 2013, the IRS granted limited relief from the regulations by extending the effective date of the new temporary regulations until the date that they are finalized.

In detail

An identified mixed straddle is a straddle (that is, holding offsetting positions with respect to actively traded property) involving a Section 1256 contract (for example, a Treasury futures) and a non-Section 1256 contract (for example, a corporate bond) that is specifically identified. In recent years, taxpayers with capital loss carryforwards have engaged in identified mixed straddle transactions in order to recognize built-in capital gain in certain fixed-rate bonds for the purpose of offsetting their capital loss carryforwards. A taxpayer may choose to avail itself of the identified mixed straddle provisions by identifying the offsetting positions as an 'identified mixed straddle' on the date the

transaction creating the mixed straddle is executed.

On August 1, 2013, the IRS issued temporary and proposed Treasury regulations changing the manner in which built-in gain or loss is recognized on positions (for example, the identified corporate bond) held prior to executing the identified mixed straddle.

The 'Old' Regulations - Treasury Regulation Section 1.1092(b)-3T(b)(6): Under the old regulations, the taxpayer was required to mark any built-in gain or loss on positions that were held prior to the date that the identified mixed straddle transaction was executed (for example, upon a taxpayer entering into an offsetting Treasury futures).

The 'New' Regulations - Treasury Regulation Section 1.1092(b)-6T as issued on August 1, 2013: Under the 'new' temporary regulations, built-in gain or loss is not recognized. Instead, the taxpayer must determine the amount of the built-in gain or loss at the time the transaction is executed for purposes of applying the remaining provisions of the identified mixed straddle rules, but the built-in gain or loss is recognized in accordance with general tax principles (that is, generally, under realization-based accounting). This section applied to all identified mixed straddles executed after August 1, 2013.

*The ‘Amended’ Regulations -
Treasury Regulation Section
1.1092(b)-6T as amended on October*

25, 2013: In light of comments received by the IRS, the ‘new’ regulations were amended by delaying their effective date. Specifically, the ‘new’ regulations apply to identified mixed straddles executed after the regulations are made final. Consequently, taxpayers may follow the ‘old’ regulations and mark built-in gain or loss upon executing an identified mixed straddle until the IRS

finalizes the ‘new’ regulations. In the preamble, the IRS notified taxpayers that it intends to finalize the regulations on or before June 30, 2014.

The takeaway

Until the IRS finalizes the ‘new’ regulations, the ‘old’ regulations requiring taxpayers to recognize built-in gain or loss upon executing an identified mixed straddle are effective. Accordingly, taxpayers with expiring capital loss carryovers are permitted

to use identified mixed straddles as a means to trigger economic gain in their fixed-rate bond positions. However, the use of this strategy will be ineffective when the IRS finalizes the ‘new’ regulations as published and amended. The IRS has notified taxpayers of its intention to finalize the ‘new’ regulations on or before June 30, 2014.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

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