

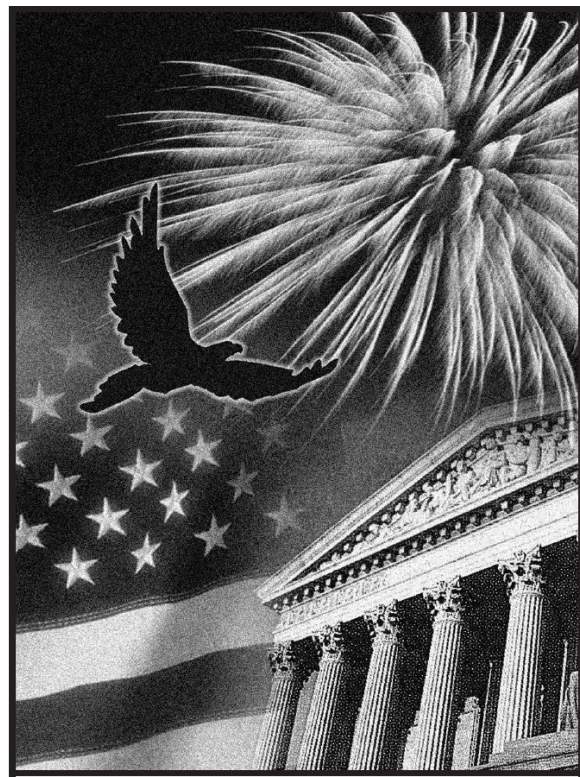
# Publication 550

## Investment Income and Expenses

(Including Capital Gains and Losses)

For use in preparing **2023** Returns

Volume 7 of 8



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**Options and futures contracts.** The wash sale rules apply to losses from sales or trades of contracts and options to acquire or sell stock or securities. They do not apply to losses from sales or trades of commodity futures contracts and foreign currencies. See Coordination of Loss Deferral Rules and Wash Sale Rules, later, for information about the tax treatment of losses on the disposition of positions in a straddle.

**Securities futures contract to sell.** Losses from the sale, exchange, or termination of a securities futures contract to sell are generally treated in the same manner as losses from the closing of a short sale, discussed later in this section under Short sales.

**Warrants.** The wash sale rules apply if you sell common stock at a loss and, at the same time, buy warrants for common stock of the same corporation. But if you sell warrants at a loss and, at the same time, buy common

stock in the same corporation, the wash sale rules apply only if the warrants and stock are considered substantially identical, as discussed next.

**Substantially identical.** In determining whether stock or securities are substantially identical, you must consider all the facts and circumstances in your particular case.

Ordinarily, stocks or securities of one corporation are not considered substantially identical to stocks or securities of another corporation. However, they may be substantially identical in some cases. For example, in a reorganization, the stocks and securities of the predecessor and successor corporations may be substantially identical.

Similarly, bonds or preferred stock of a corporation are not ordinarily considered substantially identical to the common stock of the same corporation. However, where the bonds or preferred stock are convertible into common stock of the same corporation, the

relative values, price changes, and other circumstances may make these bonds or preferred stock and the common stock substantially identical. For example, preferred stock is substantially identical to the common stock if the preferred stock:

- Is convertible into common stock,
- Has the same voting rights as the common stock,
- Is subject to the same dividend restrictions,
- Trades at prices that do not vary significantly from the conversion ratio, and
- Is unrestricted as to convertibility.

**More or less stock bought than sold.** If the number of shares of substantially identical stock or securities you buy within 30 days before or after the sale is either more or less than the number of shares you sold, you

must determine the particular shares to which the wash sale rules apply. You do this by matching the shares bought with an equal number of the shares sold. Match the shares bought in the same order that you bought them, beginning with the first shares bought. The shares or securities so matched are subject to the wash sale rules.

**Example 1.** You bought 100 shares of M stock on September 20, 2022, for \$5,000. On December 13, 2022, you bought 50 shares of substantially identical stock for \$2,750. On December 20, 2022, you bought 25 shares of substantially identical stock for \$1,125. On January 3, 2023, you sold for \$4,000 the 100 shares you bought in September. You have a \$1,000 loss on the sale. However, because you bought 75 shares of substantially identical stock within 30 days before the sale, you cannot deduct the loss (\$750) on 75 shares. You can deduct the loss (\$250) on the other 25 shares. The basis of the 50 shares

bought on December 13, 2022, is increased by two-thirds ( $50 \div 75$ ) of the \$750 disallowed loss. The new basis of those shares is \$3,250 ( $\$2,750 + \$500$ ). The basis of the 25 shares bought on December 20, 2022, is increased by the rest of the loss to \$1,375 ( $\$1,125 + \$250$ ).

**Example 2.** You bought 100 shares of M stock on September 16, 2022. On January 27, 2023, you sold those shares at a \$1,000 loss. On each of the 4 days from February 1, 2023, to February 4, 2023, you bought 50 shares of substantially identical stock. You cannot deduct your \$1,000 loss. You must add half the disallowed loss (\$500) to the basis of the 50 shares bought on February 1. Add the other half (\$500) to the basis of the shares bought on February 2.

**Loss and gain on same day.** Loss from a wash sale of one block of stock or securities cannot be used to reduce any gains on identical blocks sold the same day.

**Example.** During 2017, you bought 100 shares of X stock on each of three occasions. You paid \$158 per share for the first block of 100 shares, \$100 per share for the second block, and \$95 per share for the third block. On December 27, 2022, you sold 300 shares of X stock for \$125 per share. On January 10, 2023, you bought 250 shares of identical X stock. You cannot deduct the loss of \$33 per share on the first block because within 30 days after the date of sale you bought 250 identical shares of X stock. In addition, you cannot reduce the gain realized on the sale of the second and third blocks of stock by this loss.

**Dealers.** The wash sale rules do not apply to a dealer in stock or securities if the loss is from a transaction made in the ordinary course of business.

**Short sales.** The wash sale rules apply to a loss realized on a short sale if you sell, or enter into another short sale of, substantially



identical stock or securities within a period beginning 30 days before the date the short sale is complete and ending 30 days after that date.

For purposes of the wash sale rules, a short sale is considered complete on the date the short sale is entered into if:

- On that date, you own stock or securities identical to those sold short (or by that date you enter into a contract or option to acquire that stock or those securities); and
- You later deliver the stock or securities to close the short sale.

Otherwise, a short sale is not considered complete until the property is delivered to close the sale.

This treatment also applies to losses from the sale, exchange, or termination of a securities futures contract to sell.

**Example.** On June 4, you buy 100 shares of stock for \$1,000. You sell short 100 shares of the stock for \$750 on October 15. On October 16, you buy 100 shares of the same stock for \$750. You close the short sale on November 19 by delivering the shares bought on June 4. You cannot deduct the \$250 loss (\$1,000 – \$750) because the date of entering into the short sale (October 15) is considered the date the sale is complete for wash sale purposes and you bought substantially identical stock within 30 days from that date.

**Residual interests in a real estate mortgage investment conduit (REMIC).**

The wash sale rules will generally apply to the sale of your residual interest in a REMIC if, during the period beginning 6 months before the sale of the interest and ending 6 months after that sale, you acquire any residual interest in any REMIC or any interest in a taxable mortgage pool that is comparable to a

residual interest. REMICs are discussed in chapter 1.

**Nondeductible wash sale loss.** If you received a Form 1099-B, box 1g will show the amount of wash sale loss disallowed if:

- The stock or securities sold were covered securities, and
- The substantially identical stock or securities you bought had the same CUSIP numbers as the stock or securities you sold and were bought in the same account as the stock or securities you sold.

However, you cannot deduct a loss from a wash sale even if it is not reported on Form 1099-B.

**How to report.** Report a wash sale transaction in Part I or Part II of Form 8949 with the appropriate box checked. Complete all columns. Enter "W" in column (f). Enter as a positive number in column (g) the amount

of the loss not allowed. See the Instructions for Form 8949.

## **Securities Futures Contracts**

A securities futures contract is a contract of sale for future delivery of a single security or of a narrow-based security index.

Gain or loss from the contract will generally be treated in a manner similar to gain or loss from transactions in the underlying security. This means gain or loss from the sale, exchange, or termination of the contract will generally have the same character as gain or loss from transactions in the property to which the contract relates. Any capital gain or loss on a sale, exchange, or termination of a contract to sell property will be considered short term, regardless of how long you hold the contract. These contracts are not section 1256 contracts (unless they are dealer securities futures contracts).

# Options

Options are generally subject to the rules described in this section. If the option is part of a straddle, the Loss Deferral Rules covered later under *Straddles* may also apply. For special rules that apply to nonequity options and dealer equity options, see Section 1256 Contracts Marked to Market, earlier.

Gain or loss from the sale or trade of an option to buy or sell property that is a capital asset in your hands, or would be if you acquired it, is capital gain or loss. If the property is not or would not be a capital asset, the gain or loss is ordinary gain or loss.

**Example 1.** You purchased an option to buy 100 shares of XYZ Company stock. The stock increases in value, and you sell the option for more than you paid for it. Your gain is capital gain because the stock underlying the option would have been a capital asset in your hands.

**Example 2.** The facts are the same as in *Example 1*, except the stock decreases in value and you sell the option for less than you paid for it. Your loss is a capital loss.

**Option not exercised.** If you have a loss because you did not exercise an option to buy or sell, you are considered to have sold or traded the option on the date it expired.

**Writer of option.** If you write (grant) an option, how you report your gain or loss depends on whether it was exercised.

If you are not in the business of writing options and an option you write on stocks, securities, commodities, or commodity futures is not exercised (or repurchased), the amount you receive is a short-term capital gain.

If an option requiring you to buy or sell property is exercised, see *Writers of puts and calls*, later.

**Section 1256 contract options.** Gain or loss is recognized on the exercise of an option on a section 1256 contract. Section 1256 contracts are defined under Section 1256 Contracts Marked to Market, earlier.

**Cash settlement option.** A cash settlement option is treated as an option to buy or sell property. A cash settlement option is any option that on exercise is settled in, or could be settled in, cash or property other than the underlying property.

**How to report.** Report on Form 8949 gain or loss from the closing or expiration of an option that is not a section 1256 contract but is a capital asset in your hands. If an option you purchased expired, enter the expiration date in column (c) and enter "Expired" in column (d). If an option that was granted (written) expired, enter the expiration date in column (b) and enter "Expired" in column (e). Fill in the other columns as appropriate.

If a call option you sold was exercised and the option premium you received was not reflected in the sales price shown on the Form 1099-B you received, enter the premium as a positive number in column (g) of Form 8949 and enter "E" in column (f).

## **Puts and Calls**

Puts and calls are options on securities and are covered by the rules just discussed for options. The following are specific applications of these rules to holders and writers of options that are bought, sold, or "closed out" in transactions on a national securities exchange, such as the Chicago Board Options Exchange. (But see *Section 1256 Contracts Marked to Market*, earlier, for special rules that may apply to nonequity options and dealer equity options.) These rules are also presented in Table 4-3.



Puts and calls are issued by writers (grantors) to holders for cash premiums. They are ended by exercise, closing transaction, or lapse.

A “put option” is the right to sell to the writer, at any time before a specified future date, a stated number of shares at a specified price. Conversely, a “call option” is the right to buy from the writer of the option, at any time before a specified future date, a stated number of shares of stock at a specified price.

**Holders of puts and calls.** If you buy a put or a call, you may not deduct its cost. It is a capital expenditure.

If you sell the put or the call before you exercise it, the difference between its cost and the amount you receive for it is either a long-term or short-term capital gain or loss, depending on how long you held it.

If the option expires, its cost is either a long-term or short-term capital loss, depending on

your holding period, which ends on the expiration date.

If you exercise a call, add its cost to the basis of the stock you bought. If you exercise a put, reduce your amount realized on the sale of the underlying stock by the cost of the put when figuring your gain or loss. Any gain or loss on the sale of the underlying stock is long term or short term depending on your holding period for the underlying stock.

***Put option as short sale.*** Buying a put option is generally treated as a short sale, and the exercise, sale, or expiration of the put is a closing of the short sale. See *Short Sales*, earlier. If you have held the underlying stock for 1 year or less at the time you buy the put, any gain on the exercise, sale, or expiration of the put is a short-term capital gain. The same is true if you buy the underlying stock after you buy the put but before its exercise, sale, or expiration. Your

holding period for the underlying stock begins on the earliest of:

- The date you dispose of the stock,
- The date you exercise the put,
- The date you sell the put, or
- The date the put expires.

**Writers of puts and calls.** If you write (grant) a put or a call, do not include the amount you receive for writing it in your income at the time of receipt. Carry it in a deferred account until:

- Your obligation expires;
- You buy, in the case of a put, or sell, in the case of a call, the underlying stock when the option is exercised; or
- You engage in a closing transaction.

If your obligation expires, the amount you received for writing the call or put is short-term capital gain.

If a put you write is exercised and you buy the underlying stock, decrease your basis in the stock by the amount you received for the put. Your holding period for the stock begins on the date you buy it, not on the date you wrote the put.

If a call you write is exercised and you sell the underlying stock, increase your amount realized on the sale of the stock by the amount you received for the call when figuring your gain or loss. The gain or loss is long term or short term depending on your holding period of the stock.

If you enter into a closing transaction by paying an amount equal to the value of the put or call at the time of the payment, the difference between the amount you pay and the amount you receive for the put or call is a short-term capital gain or loss.

### **Examples of nondealer transactions.**

1. ***Expiration.*** Ten JJJ call options were issued on April 7, 2023, for \$4,000. These equity options expired in December 2023 without being exercised. If you were a holder (buyer) of the options, you would recognize a short-term capital loss of \$4,000. If you were a writer of the options, you would recognize a short-term capital gain of \$4,000.
2. ***Closing transaction.*** The facts are the same as in (1), except that on May 5, 2023, the options were sold for \$6,000. If you were the holder of the options who sold them, you would recognize a short-term capital gain of \$2,000. If you were the writer of the options and you bought them back, you would recognize a short-term capital loss of \$2,000.
3. ***Exercise.*** The facts are the same as in (1), except that the options were

exercised on May 19, 2023. The buyer adds the cost of the options to the basis of the stock bought through the exercise of the options. The writer adds the amount received from writing the options to the amount realized from selling the stock to figure gain or loss. The gain or loss is short term or long term depending upon the holding period of the stock.

4. ***Section 1256 contracts.*** The facts are the same as in (1), except the options were nonequity options, subject to the rules for section 1256 contracts. If you were a buyer of the options, you would recognize a short-term capital loss of \$1,600, and a long-term capital loss of \$2,400. If you were a writer of the options, you would recognize a short-term capital gain of \$1,600, and a long-term capital gain of \$2,400. See Section

1256 Contracts Marked to Market,  
earlier, for more information.

## **Straddles**

This section discusses the loss deferral rules that apply to the sale or other disposition of positions in a straddle. These rules do not apply to the straddles described under Exceptions, later.

A straddle is any set of offsetting positions on personal property. For example, a straddle may consist of a purchased option to buy and a purchased option to sell on the same number of shares of the security, with the same exercise price and period.

**Personal property.** This is any actively traded property. It includes stock options and contracts to buy stock but generally does not include stock.

***Straddle rules for stock.*** Although stock is generally excluded from the definition of

personal property when applying the straddle rules, it is included in the following two situations.

1. The stock is of a type that is actively traded, and at least one of the offsetting positions is a position on that stock or substantially similar or related property.
2. The stock is in a corporation formed or availed of to take positions in personal property that offset positions taken by any shareholder.



Table 4-3. **Puts and Calls**

Puts		
When a put:	If you are the holder:	If you are the writer:
Is exercised	Reduce your amount realized from the sale of the underlying stock by the cost of the put.	Reduce your basis in the stock you buy by the amount you received for the put.
Expires	Report the cost of the put as a capital loss on the date it expires.*	Report the amount you received for the put as a short-term capital gain.
Is sold by the holder	Report the difference between the cost of the put and the amount you receive for it as a capital gain or loss.*	This does not affect you. (But if you buy back the put, report the difference between the amount you pay and the amount you received for the put as a short-term capital gain or loss.)

Calls		
When a call:	If you are the holder:	If you are the writer:
Is exercised	Add the cost of the call to your basis in the stock purchased.	Increase your amount realized on sale of the stock by the amount you received for the call.
Expires	Report the cost of the call as a capital loss on the date it expires.*	Report the amount you received for the call as a short-term capital gain.
Is sold by the holder	Report the difference between the cost of the call and the amount you receive for it as a capital gain or loss.*	This does not affect you. (But if you buy back the call, report the difference between the amount you pay and the amount you received for the call as a short-term capital gain or loss.)

\* See [Holders of puts and calls](#) and [Writers of puts and calls](#) in the accompanying text to find whether your gain or loss is short term or long term.

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**Note.** For positions established before October 22, 2004, condition 1 above does not apply. Instead, personal property includes stock if condition 2 above applies or the stock was part of a straddle in which at least one of the offsetting positions was:

- An option to buy or sell the stock or substantially identical stock or securities,
- A securities futures contract on the stock or substantially identical stock or securities, or
- A position on substantially similar or related property (other than stock).

**Position.** A position is an interest in personal property. A position can be a forward or futures contract or an option.

An interest in a loan denominated in a foreign currency is treated as a position in that currency. For the straddle rules, foreign currency for which there is an active

interbank market is considered to be actively traded personal property. See also Foreign currency contract, earlier.

**Offsetting position.** This is a position that substantially reduces any risk of loss you may have from holding another position. However, if a position is part of a straddle that is not an identified straddle (described later), do not treat it as offsetting to a position that is part of an identified straddle.

***Presumed offsetting positions.*** Two or more positions will be presumed to be offsetting if:

- The positions are established in the same personal property (or in a contract for this property), and the value of one or more positions varies inversely with the value of one or more of the other positions;
- The positions are in the same personal property, even if this property is in a

substantially changed form, and the positions' values vary inversely as described in the first condition;

- The positions are in debt instruments with a similar maturity, and the positions' values vary inversely as described in the first condition;
- The positions are sold or marketed as offsetting positions, whether or not the positions are called a straddle, spread, butterfly, or any similar name; or
- The aggregate margin requirement for the positions is lower than the sum of the margin requirements for each position if held separately.

***Related persons.*** To determine if two or more positions are offsetting, you will be treated as holding any position your spouse holds during the same period. If you take into account part or all of the gain or loss for a position held by a flow-through entity, such

as a partnership or trust, you are also considered to hold that position.

## **Loss Deferral Rules**

Generally, you can deduct a loss on the disposition of one or more positions only to the extent the loss is more than any unrecognized gain you have on offsetting positions.

Unused losses are treated as sustained in the next tax year.

**Unrecognized gain.** This is:

- The amount of gain you would have had on an open position if you had sold it on the last business day of the tax year at its fair market value; and
- The amount of gain realized on a position if, as of the end of the tax year, gain has been realized but not recognized.

**Example.** On July 7, 2023, you entered into a straddle. On December 11, 2023, you closed one position of the straddle at a loss of \$15,000. On December 30, 2023, the end of your tax year, you have an unrecognized gain of \$12,750 in the offsetting open position. On your 2023 return, your deductible loss on the position you closed is limited to \$2,250 ( $\$15,000 - \$12,750$ ). You must carry forward the unused loss of \$12,750.

**Note.** If you physically settle a position established after October 21, 2004, that is part of a straddle by delivering property to which the position relates (and you would realize a loss on that position if you terminated it), you are treated as having terminated the position for its fair market value immediately before the settlement and as having sold the property used to physically settle the position at its fair market value.

**Exceptions.** The loss deferral rules do not apply to:

1. Positions established after October 21, 2004, comprising an identified straddle;
2. Certain straddles consisting of qualified covered call options and the stock to be purchased under the options;
3. Hedging transactions, described earlier under *Section 1256 Contracts Marked to Market*; and
4. Straddles consisting entirely of section 1256 contracts, as described earlier under Section 1256 Contracts Marked to Market (but see Identified straddle, later).

**Note.** For positions established before October 22, 2004, the loss deferral rules also do not apply to a straddle that is an identified straddle at the end of the tax year.

***Identified straddle.*** Any straddle (other than a straddle described in (2) or (3) above)



is an identified straddle if all the following conditions exist.

- You clearly identified the straddle on your records before the close of the day on which you acquired it.
- For straddles acquired after December 29, 2007, you identified the positions in the straddle that are offsetting with respect to one another (for example, position A offsets position D, and position B offsets position C).
- The straddle is not part of a larger straddle.

If there is a loss from any position in an identified straddle, you must increase the basis of each of the positions that offset the loss position in the identified straddle. The increase is the loss multiplied by the following fraction:

$$\frac{\text{Unrecognized gain (if any) on the offsetting position}}{\text{The total unrecognized gain on all positions that offset the loss position in the identified straddle}}$$

For this purpose, your unrecognized gain is the excess of the fair market value of the position that is part of an identified straddle at the time you incur a loss on another position in the identified straddle, over the fair market value of that position when you identified it as a position in the straddle.

If the application of the above rule does not result in the increase in basis of any offsetting position in the identified straddle, you must increase the basis of each of the offsetting positions in the straddle in a manner that:

- Is reasonable,
- Is consistently applied by you,
- Is consistent with the purposes of the identified straddle rules, and
- Results in a total increase in the basis of those offsetting positions equal to the loss.

If you adopt an allocation method under this rule, you must describe that method in your books and records.

The identified straddle rules also apply to positions that are or have been a liability or obligation to you (for example, a debt obligation you issued, a written option, or a notional principal contract you entered into).

Neither you nor anyone else can take into account any loss on a position that is part of an identified straddle to the extent the loss increases the basis of any positions that offset the loss position in the identified straddle.

**Note.** For positions established before October 22, 2004, identified straddles have to meet two additional conditions.

1. All the original positions that you identify were acquired on the same day.
2. All the positions included in condition 1 were disposed of on the same day during the tax year, or none of the positions were disposed of by the end of the tax year.

Also, the losses from positions are deferred until you dispose of all the positions in the straddle. The rule discussed above for increasing the basis of each of the positions does not apply.

***Qualified covered call options and optioned stock.*** A straddle is not subject to the loss deferral rules for straddles if both of the following are true.

- All the offsetting positions consist of one or more qualified covered call options and the stock to be purchased from you under the options.
- The straddle is not part of a larger straddle.

But see *Special year-end rule*, later, for an exception.

A qualified covered call option is any option you grant to purchase stock you hold (or stock you acquire in connection with granting the option), but only if all the following are true.

- The option is traded on a national securities exchange or other market approved by the Secretary of the Treasury.
- The option is granted more than 30 days before its expiration date.

For covered call options entered into after July 28, 2002, the option is granted not more than 12 months before its expiration date or satisfies term limitation and qualified benchmark requirements published in the Internal Revenue Bulletin.

- The option is not a deep-in-the-money option.
- You are not an options dealer who granted the option in connection with your activity of dealing in options.
- Gain or loss on the option is capital gain or loss.

A deep-in-the-money option is an option with a strike price lower than the lowest qualified benchmark (LQB). The strike price is the price at which the option is to be exercised. Strike prices are listed in the financial sections of many newspapers. The LQB is the highest available strike price that is less than the applicable stock price. However, the LQB for

an option with a term of more than 90 days and a strike price of more than \$50 is the second-highest available strike price that is less than the applicable stock price.

The availability of strike prices for equity options with flexible terms does not affect the determination of the LQB for an option that is not an equity option with flexible terms.

The applicable stock price for any stock for which an option has been granted is:

1. The closing price of the stock on the most recent day on which that stock was traded before the date on which the option was granted; or
2. The opening price of the stock on the day on which the option was granted, but only if that price is greater than 110% of the price determined in (1).

If the applicable stock price is \$25 or less, the LQB will be treated as not less than 85% of the applicable stock price. If the applicable

stock price is \$150 or less, the LQB will be treated as not less than an amount that is \$10 below the applicable stock price.

**Example.** On May 12, 2023, you held XYZ stock and you wrote an XYZ/September call option with a strike price of \$120. The closing price of one share of XYZ stock on May 11, 2023, was \$130.25. The strike prices of all XYZ/ September call options offered on May 12, 2023, were as follows: \$110, \$115, \$120, \$125, \$130, and \$135. Because the option has a term of more than 90 days, the LQB is \$125, the second-highest strike price that is less than \$130.25, the applicable stock price. The call option is a deep-in-the-money option because its strike price is lower than the LQB. As a result, the option is not a qualified covered call option, and the loss deferral rules apply if you closed out the option or the stock at a loss during the year.

**Capital loss on qualified covered call options.** If you hold stock and you write a



qualified covered call option on that stock with a strike price less than the applicable stock price, treat any loss from the option as long-term capital loss if, at the time the loss was realized, gain on the sale or exchange of the stock would be treated as long-term capital gain. The holding period of the stock does not include any period during which you are the writer of the option.

***Special year-end rule.*** The loss deferral rules for straddles apply if all the following are true.

- The qualified covered call options are closed, or the stock is disposed of at a loss during any tax year.
- Gain on disposition of the stock or gain on the options is includible in gross income in a later tax year.
- The stock or options were held less than 30 days after the closing of the options or the disposition of the stock.

## **How To Report Gains and Losses (Form 6781)**

As a general rule, report each position (whether or not it is part of a straddle) on which you have unrecognized gain at the end of the tax year and the amount of this unrecognized gain in Part III of Form 6781. Use Part II of Form 6781 to figure your gains and losses on straddles. See the Form 6781 instructions for how to report these gains and losses.

## **Coordination of Loss Deferral Rules and Wash Sale Rules**

Rules similar to the wash sale rules apply to any disposition of a position or positions of a straddle. First apply Rule 1, explained next, then apply Rule 2. However, Rule 1 applies only if stocks or securities make up a position that is part of the straddle. If a position in the straddle does not include stock or securities, use Rule 2.

**Rule 1.** You cannot deduct a loss on the disposition of shares of stock or securities that make up the positions of a straddle if, within a period beginning 30 days before the date of that disposition and ending 30 days after that date, you acquired substantially identical stock or securities. Instead, the loss will be carried over to the following tax year, subject to any further application of Rule 1 in that year. This rule will also apply if you entered into a contract or option to acquire the stock or securities within the time period described above. See Loss carryover, later, for more information about how to treat the loss in the following tax year.

**Dealers.** If you are a dealer in stock or securities, this loss treatment will not apply to any losses you sustained in the ordinary course of your business.

**Example.** You are not a dealer in stock or securities. On December 1, 2023, you bought stock in XX Corporation (XX stock) and an

offsetting put option. On December 8, 2023, there was \$20 of unrealized gain in the put option and you sold the XX stock at a \$20 loss. By December 15, 2023, the value of the put option had declined, eliminating all unrealized gain in the position. On December 15, you bought a second XX stock position that is substantially identical to the XX stock you sold on December 8. At the end of the year, there is no unrecognized gain in the put option or in the XX stock. Under these circumstances, the \$20 loss will be disallowed for 2023 under Rule 1 because, within a period beginning 30 days before December 8 and ending 30 days after that date, you bought stock substantially identical to the XX stock you sold.

**Rule 2.** You cannot deduct a loss on the disposition of less than all the positions of a straddle (your loss position) to the extent that any unrecognized gain at the close of the tax year in one or more of the following positions

is more than any loss disallowed under Rule 1.

- Successor positions.
- Offsetting positions to the loss position.
- Offsetting positions to any successor position.

***Successor position.*** A successor position is a position that is or was at any time offsetting to a second position if both the following conditions are met.

- The second position was offsetting to the loss position that was sold.
- The successor position is entered into during a period beginning 30 days before and ending 30 days after the sale of the loss position.

***Example 1.*** On November 3, 2023, you entered into offsetting long and short positions in non-section 1256 contracts. On

November 10, 2023, you disposed of the long position at a \$10 loss. On November 17, 2023, you entered into a new long position (successor position) that is offsetting to the retained short position, but not substantially identical to the long position disposed of on November 10. You held both positions through year end, at which time there was \$10 of unrecognized gain in the successor long position and no unrecognized gain in the offsetting short position. Under these circumstances, the entire \$10 loss will be disallowed for 2023 because there is \$10 of unrecognized gain in the successor long position.

**Example 2.** The facts are the same as in *Example 1*, except that at year end you have \$4 of unrecognized gain in the successor long position and \$6 of unrecognized gain in the offsetting short position. Under these circumstances, the entire \$10 loss will be disallowed for 2023 because there is a total of

\$10 of unrecognized gain in the successor long position and offsetting short position.

**Example 3.** The facts are the same as in *Example 1*, except that at year end you have \$8 of unrecognized gain in the successor long position and \$8 of unrecognized loss in the offsetting short position. Under these circumstances, \$8 of the total \$10 realized loss will be disallowed for 2023 because there is \$8 of unrecognized gain in the successor long position.

**Loss carryover.** If you have a disallowed loss that resulted from applying Rule 1 and Rule 2, you must carry it over to the next tax year and apply Rule 1 and Rule 2 to that carryover loss. For example, a loss disallowed in 2022 under Rule 1 will not be allowed in 2023, unless the substantially identical stock or securities (which caused the loss to be disallowed in 2022) were disposed of during 2023. In addition, the carryover loss will not

be allowed in 2023 if Rule 1 or Rule 2 disallows it.

**Example.** The facts are the same as in the example under *Rule 1*. On December 29, 2024, you sell the second XX stock at a \$20 loss and there is \$40 of unrecognized gain in the put option. Under these circumstances, you cannot deduct in 2024 either the \$20 loss disallowed in 2023 or the \$20 loss you incurred for the December 29, 2024, sale of XX stock. Rule 1 does not apply because the substantially identical XX stock was sold during the year and no substantially identical stock or securities were bought within the 61-day period. However, Rule 2 does apply because there is \$40 of unrecognized gain in the put option, an offsetting position to the loss positions.

**Capital loss carryover.** If the sale of a loss position would have resulted in a capital loss, you treat the carryover loss as a capital loss on the date it is allowed, even if you would



treat the gain or loss on any successor positions as ordinary income or loss. Likewise, if the sale of a loss position (in the case of section 1256 contracts) would have resulted in a 60% long-term capital loss and a 40% short-term capital loss, you treat the carryover loss under the 60/40 rule, even if you would treat any gain or loss on any successor positions as 100% long-term or short-term capital gain or loss.

**Exceptions.** The rules for coordinating straddle losses and wash sales do not apply to the following loss situations.

- Loss on the sale of one or more positions in a hedging transaction. (Hedging transactions are described under Section 1256 Contracts Marked to Market, earlier.)
- Loss on the sale of a loss position in a mixed straddle account. (See Mixed straddle account (Election C), later.)

- Loss on the sale of a position that is part of a straddle consisting only of section 1256 contracts.

## **Holding Period and Loss Treatment Rules**

The holding period of a position in a straddle generally begins no earlier than the date on which the straddle ends (the date you no longer hold an offsetting position). This rule does not apply to any position you held more than 1 year before you established the straddle. But see *Exceptions*, later.

**Example.** On March 10, 2022, you acquired gold. On January 10, 2023, you entered into an offsetting short gold forward contract (nonregulated futures contract). On April 3, 2023, you disposed of the short gold forward contract at no gain or loss. On April 13, 2023, you sold the gold at a gain. Because the gold had been held for 1 year or less before the offsetting short position was entered into, the holding period for the gold begins on April 3, 2023, the date the straddle ended. Gain

recognized on the sale of the gold will be treated as short-term capital gain.

**Loss treatment.** Treat the loss on the sale of one or more positions (the loss position) of a straddle as a long-term capital loss if both the following are true.

- You held (directly or indirectly) one or more offsetting positions to the loss position on the date you entered into the loss position.
- You would have treated all gain or loss on one or more of the straddle positions as long-term capital gain or loss if you had sold these positions on the day you entered into the loss position.

***Mixed straddles.*** Special rules apply to a loss position that is part of a mixed straddle and that is a non-section 1256 position. A mixed straddle is a straddle:

- That is not part of a larger straddle,

- In which all positions are held as capital assets,
- In which at least one (but not all) of the positions is a section 1256 contract, and
- For which the mixed straddle election (Election A, discussed later) has not been made.

Treat the loss as 60% long-term capital loss and 40% short-term capital loss if all the following conditions apply.

- Gain or loss from the sale of one or more of the straddle positions that are section 1256 contracts would be considered gain or loss from the sale or exchange of a capital asset.
- The sale of no position in the straddle, other than a section 1256 contract, would result in a long-term capital gain or loss.

- You have not made a straddle-by-straddle identification election (Election B) or mixed straddle account election (Election C), both discussed later.

**Example.** On March 3, 2023, you entered into a long gold forward contract. On July 14, 2023, you entered into an offsetting short gold regulated futures contract. You did not make an election to offset gains and losses from positions in a mixed straddle. On August 4, 2023, you disposed of the long forward contract at a loss. Because the gold forward contract was part of a mixed straddle and the disposition of this non-section 1256 position would not result in long-term capital loss, the loss recognized on the termination of the gold forward contract will be treated as a 60% long-term and 40% short-term capital loss.

**Exceptions.** The special holding period and loss treatment for straddle positions does not apply to positions that:

- Constitute part of a hedging transaction;
- Are included in a straddle consisting only of section 1256 contracts; or
- Are included in a mixed straddle account (Election C), discussed later.

## **Mixed Straddle Elections**

If you disposed of a position in a mixed straddle and make one of the elections described in the following discussions, report your gain or loss as indicated in those discussions. If you do not make any of the elections, report your gain or loss in Part II of Form 6781. If you disposed of the section 1256 component of the straddle, enter the recognized loss (line 10, column (h)) or your gain (line 12, column (f)) in Part I of Form 6781, on line 1. Do not include it on line 11 or 13 (Part II).

**Mixed straddle election (Election A).** You can elect out of the marked-to-market rules,

discussed under Section 1256 Contracts Marked to Market, earlier, for all section 1256 contracts that are part of a mixed straddle. Instead, the gain and loss rules for straddles will apply to these contracts. However, if you make this election for an option on a section 1256 contract, the gain or loss treatment discussed earlier under Options will apply, subject to the gain and loss rules for straddles.

You can make this election if:

- At least one (but not all) of the positions is a section 1256 contract, and
- Each position forming part of the straddle is clearly identified as being part of that straddle on the day the first section 1256 contract forming part of the straddle is acquired.

If you make this election, it will apply for all later years as well. It cannot be revoked

without the consent of the IRS. If you made this election, check box A of Form 6781. Do not report the section 1256 component in Part I.

**Other elections.** You can avoid the 60% long-term capital loss treatment required for a non-section 1256 loss position that is part of a mixed straddle, described earlier, if you choose either of the two following elections to offset gains and losses for these positions.

- ***Election B.*** Make a separate identification of the positions of each mixed straddle for which you are electing this treatment (the straddle-by-straddle identification method).
- ***Election C.*** Establish a mixed straddle account for a class of activities for which gains and losses will be recognized and offset on a periodic basis.



These two elections are alternatives to the mixed straddle election. You can choose only one of the three elections. Use Form 6781 to indicate your election choice by checking box A, B, or C, whichever applies.

***Straddle-by-straddle identification election (Election B).*** Under this election, you must clearly identify each position that is part of the identified mixed straddle by the earlier of:

- The close of the day the identified mixed straddle is established, or
- The time the position is disposed of.

If you dispose of a position in the mixed straddle before the end of the day on which the straddle is established, this identification must be made by the time you dispose of the position. You are presumed to have properly identified a mixed straddle if independent verification is used.

If you make this election, any positions you held on the day before the election are deemed sold for their fair market value at the close of the last business day before the day of the election. For elections made on or before August 18, 2014, take this gain or loss into account when figuring taxable income for the year in which the election was made. For elections made after August 18, 2014, take this gain or loss into account in the year you would have reported the gain or loss if the identified mixed straddle had not been established. In addition, when the gain or loss that accrued prior to the time the identified mixed straddle was established is taken into account, it will have the same character it would have had if the identified mixed straddle had not been established. See Regulations section 1.1092(b)-6 for details.

The basic tax treatment of gain or loss under this election depends on which side of the straddle produced the total net gain or loss. If

the net gain or loss from the straddle is due to the section 1256 contracts, gain or loss is treated as 60% long-term capital gain or loss and 40% short-term capital gain or loss.

Enter the net gain or loss in Part I of Form 6781 and identify the election by checking box B.

If the net gain or loss is due to the non-section 1256 positions, gain or loss is short-term capital gain or loss. See the Form 6781 instructions for how to report the net gain or loss.

For the specific application of the rules of this election, see Regulations sections 1.1092(b)-3T and 1.1092(b)-6.

***Example 1.*** Straddle established on or before August 18, 2014. On April 2, 2014, you entered into a non-section 1256 position and an offsetting section 1256 contract. You also made a valid election to treat this straddle as an identified mixed straddle. On April 9, 2014, you disposed of the non-section 1256

position at a \$600 loss and the section 1256 contract at an \$800 gain. Under these circumstances, the \$600 loss on the non-section 1256 position was offset against the \$800 gain on the section 1256 contract. The net gain of \$200 from the straddle was treated as 60% long-term capital gain and 40% short-term capital gain because it was due to the section 1256 contract.

**Example 2.** Straddle established after August 18, 2014. On December 2, 2022, you entered into a non-section 1256 position for \$100. At the end of the day on January 24, 2023, the position had a value of \$500. On January 25, 2023, you entered into an offsetting section 1256 position. You elected to treat the straddle as an identified mixed straddle.

On February 10, 2023, you closed out the section 1256 contract at a \$500 loss and disposed of the non-section 1256 position for \$975. Prior to entering into the identified mixed straddle, you had a \$400 unrealized

short-term capital gain on the non-section 1256 position. When you disposed of the non-section 1256 position on February 10, 2023, you recognized the \$400 gain. This gain is figured as though you had disposed of the position on the day prior to establishing the identified mixed straddle.

You also realized a gain of \$475 (\$975 proceeds – \$500 value before entering into the identified mixed straddle). This gain is offset by the \$500 loss on the section 1256 contract for a net loss of \$25. This net loss is recognized and treated as 60% long-term capital loss and 40% short-term capital loss attributable to the section 1256 contract.

***Mixed straddle account (Election C).*** You may elect to establish one or more accounts for determining gains and losses from all positions in a mixed straddle. You must establish a separate mixed straddle account for each separate designated class of activities.

Generally, you must determine gain or loss for each position in a mixed straddle account as of the close of each business day of the tax year. You offset the net section 1256 contracts against the net non-section 1256 positions to determine the "daily account net gain or loss."

If the daily account amount is due to non-section 1256 positions, the amount is treated as short-term capital gain or loss. If the daily account amount is due to section 1256 contracts, the amount is treated as 60% long-term and 40% short-term capital gain or loss.

On the last business day of the tax year, you determine the "annual account net gain or loss" for each account by netting the daily account amounts for that account for the tax year. The "total annual account net gain or loss" is determined by netting the annual account amounts for all mixed straddle accounts that you had established.

The net amounts keep their long-term or short-term classification. However, no more than 50% of the total annual account net gain for the tax year can be treated as long-term capital gain. Any remaining gain is treated as short-term capital gain. Also, no more than 40% of the total annual account net loss can be treated as short-term capital loss. Any remaining loss is treated as long-term capital loss.

The election to establish one or more mixed straddle accounts for each tax year must be made by the due date (without extensions) of your income tax return for the immediately preceding tax year. If you begin trading in a new class of activities during a tax year, you must make the election for the new class of activities by the later of either:

- The due date of your return for the immediately preceding tax year (without extensions), or

- 60 days after you entered into the first mixed straddle in the new class of activities.

You make the election on Form 6781 by checking box

C. Attach Form 6781 to your income tax return for the immediately preceding tax year, or file it within 60 days, if that applies. Report the annual account net gain or loss from a mixed straddle account in Part II of Form 6781. In addition, you must attach a statement to Form 6781 specifically designating the class of activities for which a mixed straddle account is established.

For the specific application of the rules of this election, see Regulations section 1.1092(b)-4T.

***Interest expense and carrying charges relating to mixed straddle account positions.*** You cannot deduct interest and carrying charges that are allocable to any



positions held in a mixed straddle account. Treat these charges as an adjustment to the annual account net gain or loss and allocate them proportionately between the net short-term and the net long-term capital gains or losses.

To find the amount of interest and carrying charges that is not deductible and that must be added to the annual account net gain or loss, apply the rules described earlier to the positions held in the mixed straddle account. See *Interest expense and carrying charges on straddles* in chapter 3.

For special rules on the deferral of gain related to a straddle where the gain is invested in a Qualified Opportunity Fund, see section 1400Z-2 for more details.

## **Sales of Stock to Employee Stock Ownership Plans (ESOPs) or Certain Cooperatives**

If you sold qualified securities held for at least 3 years to an ESOP or eligible worker-owned cooperative, you may be able to elect to postpone all or part of the gain on the sale if you bought qualified replacement property (certain securities) within the period that began 3 months before the sale and ended 12 months after the sale. If you make the election, you must recognize gain on the sale only to the extent the proceeds from the sale exceed the cost of the qualified replacement property.

You must reduce the basis of the replacement property by any postponed gain. If you dispose of any replacement property, you may have to recognize all of the postponed gain.

Generally, to qualify for the election, the ESOP or cooperative must own at least 30% of the outstanding stock of the corporation that issued the qualified securities. Also, the qualified replacement property must have been issued by a domestic operating corporation.

**How to make the election.** You must make the election no later than the due date (including extensions) for filing your tax return for the year in which you sold the stock. If your original return was filed on time, you may make the election on an amended return filed no later than 6 months after the due date of your return (excluding extensions). Enter "Filed pursuant to section 301.9100-2" at the top of the amended return and file it at the same address you used for your original return.

***How to report and postpone gain.*** Report the sale in Part II of Form 8949 as you would if you were not making the election. Then

enter "R" in column (f). Enter the amount of the postponed gain as a negative number in column (g). Put it in parentheses to show it is negative. Complete all remaining columns. If the actual postponed gain is different from the amount you report, file an amended return.



*Report your sales of stock to ESOPs or certain cooperatives on Form 8949 with the correct box checked for these transactions. See Form 8949 and the Instructions for Form 8949.*

Also attach the following statements.

1. A "statement of election" that indicates you are making an election under section 1042(a) of the Internal Revenue Code and that includes the following information.
  - a. A description of the securities sold, including the type and number of shares, the date of the sale, the

amount realized on the sale, and the adjusted basis of the securities.

- b. The name of the ESOP or cooperative to which the qualified securities were sold.
  - c. For a sale that was part of a single interrelated transaction under a prearranged agreement between taxpayers involving other sales of qualified securities, the names and identifying numbers of the other taxpayers under the agreement and the number of shares sold by the other taxpayers.
2. A notarized "statement of purchase" describing the qualified replacement property, date of purchase, and the cost of the property and declaring the property to be qualified replacement property for the qualified stock you sold. The statement must have been notarized no later than 30 days after

the purchase. If you have not yet purchased the qualified replacement property, you must attach the notarized "statement of purchase" to your income tax return for the year following the election year (or the election will not be valid).

3. A verified written statement of the domestic corporation whose employees are covered by the ESOP acquiring the securities, or of any authorized officer of the cooperative, consenting to the taxes under sections 4978 and 4979A of the Internal Revenue Code on certain dispositions, and prohibited allocations of the stock purchased by the ESOP or cooperative.

**More information.** For details, see section 1042 of the Internal Revenue Code and Regulations section 1.1042-1T.

# Gains on Qualified Small Business Stock

This section discusses two provisions of the law that may apply to gain from the sale or trade of qualified small business stock. You may qualify for a tax-free rollover of all or part of the gain. You may be able to exclude gain from your income.

**Qualified small business stock.** This is stock that meets all the following tests.

1. It must be stock in a C corporation.
2. It must have been originally issued after August 10, 1993.
3. The corporation must have total gross assets of \$50 million or less at all times after August 9, 1993, and before it issued the stock. Its total gross assets immediately after it issued the stock must also be \$50 million or less.

When figuring the corporation's total gross assets, you must also count the assets of any predecessor of the corporation. In addition, you must treat all corporations that are members of the same parent-subsidary controlled group as one corporation.

4. You must have acquired the stock at its original issue, directly or through an underwriter, in exchange for money or other property (not including stock), or as pay for services provided to the corporation (other than services performed as an underwriter of the stock). In certain cases, your stock may also meet this test if you acquired it from another person who met this test, or through a conversion or trade of qualified small business stock that you held.



5. The corporation must have met the active business test, defined next, and must have been a C corporation during substantially all the time you held the stock.
6. Within the period beginning 2 years before and ending 2 years after the stock was issued, the corporation cannot have bought more than a de minimis amount of its stock from you or a related party.
7. Within the period beginning 1 year before and ending 1 year after the stock was issued, the corporation cannot have bought more than a de minimis amount of its stock from anyone, unless the total value of the stock it bought is 5% or less of the total value of all its stock.

For more information about tests 6 and 7, see the regulations under section 1202 of the Internal Revenue Code.

**Active business test.** A corporation meets this test for any period of time if, during that period, both the following are true.

- It was an eligible corporation, defined below.
- It used at least 80% (by value) of its assets in the active conduct of at least one qualified trade or business, defined below.

***Exception for Specialized Small Business Investment Company (SSBIC).*** Any SSBIC is treated as meeting the active business test. An SSBIC is an eligible corporation licensed to operate under section 301(d) of the Small Business Investment Act of 1958, as in effect on May 13, 1993.

***Eligible corporation.*** This is any U.S. corporation other than:

- A Domestic International Sales Corporation (DISC) or a former DISC;

- A corporation that has made, or whose subsidiary has made, an election under section 936 of the Internal Revenue Code;
- A regulated investment company;
- A REIT;
- A REMIC;
- Certain financial asset securitization investment trusts (FASITs); or
- A cooperative.

***Qualified trade or business.*** This is any trade or business other than:

- One involving services performed in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services;

- One whose principal asset is the reputation or skill of one or more employees;
- Any banking, insurance, financing, leasing, investing, or similar business;
- Any farming business (including the business of raising or harvesting trees);
- Any business involving the production or extraction of products for which percentage depletion can be claimed; or
- Any business of operating a hotel, motel, restaurant, or similar business.

## **Rollover of Gain**

You may qualify for a tax-free rollover of capital gain from the sale of qualified small business stock held more than 6 months. This means that, if you buy certain replacement

stock and make the choice described in this section, you postpone part or all of your gain.

You postpone the gain by adjusting the basis of the replacement stock as described in *Basis of replacement stock*, later. This postpones your gain until the year you dispose of the replacement stock.

You can make this choice if you meet all the following tests.

- You buy replacement stock during the 60-day period beginning on the date of the sale.
- The replacement stock is qualified small business stock.
- The replacement stock continues to meet the active business requirement for small business stock for at least the first 6 months after you buy it.

**Amount of gain recognized.** If you make the choice described in this section, you must

recognize the capital gain only up to the following amount.

- The amount realized on the sale, minus
- The cost of any qualified small business stock you bought during the 60-day period beginning on the date of sale (and did not previously take into account on an earlier sale of qualified small business stock).

If this amount is less than the amount of your capital gain, you can postpone the rest of that gain. If this amount equals or is more than the amount of your capital gain, you must recognize the full amount of your gain.

**Basis of replacement stock.** You must subtract the amount of postponed gain from the basis of your replacement stock.