Part III – Administrative, Procedural, and Miscellaneous

Guidance and Other Actions Being Considered Regarding Certain Potentially Abusive Investment Fund Strategies Involving Financial Products

Notice 2026-62

SECTION 1. PURPOSE

The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have identified novel investment fund strategies that purport to produce tax results that may be inconsistent with the purpose and proper application of the relevant federal tax rules. These transactions are not the result of conventional, long-established tax planning that is consistent with the intent of Congress. This notice requests comments and information regarding the transactions described in this notice and similar transactions.

Concurrently with this notice, the Treasury Department and the IRS are issuing Rev. Rul. 2026-20, this Bulletin, on the federal tax characterization of a transaction described in section 2.02(2) of this notice. The Treasury Department and the IRS are also considering issuing additional guidance or taking other action to address the transactions described in this notice. Such guidance may include regulations, notices, revenue rulings, and other guidance published in the Internal Revenue Bulletin, including the potential identification of a transaction as a transaction of interest or a listed transaction.

Whether guidance will be issued and, if so, its timing, form, and content, will depend on the details of the relevant transaction, the tax rules applicable to the transaction, and the authority available to the Treasury Department and the IRS, including anti-abuse rules and judicial doctrines. Additional information provided by stakeholders about these transactions, and about other transactions that may appear similar but have different facts, different economics, or different tax policy implications, will be taken into account. Any such guidance could apply prospectively only or retroactively to transactions that already have taken place at the time the guidance is issued.[1] The Treasury Department and the IRS intend that any guidance to address the transactions described in this notice will target specific abusive transactions, will minimize compliance burdens, and will respect market expectations with respect to conventional, long-established tax planning that is consistent with the intent of Congress.

In addition to issuing guidance, the IRS may challenge an abusive investment fund strategy upon examination as inconsistent with existing law, including the Internal Revenue Code (Code), Income Tax Regulations, and applicable judicial doctrines.[2]

SECTION 2. IDENTIFIED STRATEGIES INVOLVING ATYPICAL USAGE OF § 852(b)(6)

The Treasury Department and the IRS are aware of several strategies that involve

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[1] *See* § 7805(b)(1) (generally prescribing the extent to which regulations may apply retroactively); *see also* § 7805(b)(3) ("The Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse.").

[2] Unless otherwise provided, all "section" or "§" references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

the purported application of § 852(b)(6) to produce results that are inconsistent with the purpose and proper application of that provision. In several of these strategies, the rules applicable to transactions undertaken by exchange traded funds (ETFs) are being used not simply to operate an ETF in the normal course of carrying out its investment strategy, but instead to avoid the inclusion by the ETF or its shareholders of income or gain contemplated by subchapter M of chapter 1 of the Code (subchapter M), or other provisions of the Code.

.01 *Background.*

(1) *Recognition of realized gain*.

Under § 1001(a), gain or loss from the sale or other disposition of property is determined by reference to the amount realized on the disposition and the adjusted basis of the property. Gain or loss generally is realized upon the sale or disposition of property in exchange for cash or other property differing materially either in kind or in extent. *See* § 1.1001-1(a). Under § 1001(c), realized gain or loss is recognized except as otherwise provided in subtitle A of the Code.

Section 311(a) contains a nonrecognition rule for certain distributions by corporations to shareholders. Specifically, § 311(a) provides that a corporation recognizes no gain or loss on a distribution (not in complete liquidation) with respect to its stock of (i) its stock (or rights to acquire its stock), or (ii) property. However, § 311(b) provides a broad exception to § 311(a) that requires a corporation to recognize gain on the distribution to a shareholder of appreciated property (other than an obligation of such corporation) as if that property were sold to the shareholder at its fair market value. Section 317(a) defines “property” to mean money, securities, and any other property other than stock (or rights to acquire stock) of the corporation making the distribution.

(2) *Regulated investment companies*.

A regulated investment company (RIC), as defined in § 851, is a domestic corporation for federal income tax purposes that meets requirements specified in § 851 (for example, the income and asset diversification requirements in § 851(b)). A RIC that meets the requirements of § 852 (including, for example, the distribution requirement in § 852(a)(1)) is taxed under part I of subchapter M, which includes §§ 851 through 855. Taxation of RICs and their shareholders under part I of subchapter M is generally more favorable than taxation of non-RIC corporations subject to subchapter C of chapter 1 of the Code (subchapter C).

In particular, a RIC generally is allowed a deduction under § 852(b)(2)(D) and (3)(A) for the dividends it pays. In addition, a RIC that earns certain types of income can pay corresponding types of dividends, which allows shareholders to be taxed on the dividends in a way that approximates how the shareholders would be taxed if they had earned the income directly. For example, a RIC that has a net capital gain can pay capital gain dividends, which generally are taxed like capital gains in the hands of shareholders. Pursuant to these rules, RICs often operate in such a way that income and capital gains derived by a RIC do not give rise to income tax liability for the RIC and instead give rise to taxable income for RIC shareholders. Accordingly, although the statutory rules that apply to RICs are unique to subchapter M,[3] the application of those rules typically results in a single level of tax on the income of a RIC, which is similar to how pass-through entities, such as partnerships, are taxed.

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[3] Similar rules under part II of subchapter M apply to real estate investment trusts.

Like other corporations subject to subchapter C, a RIC generally must recognize gain upon a distribution of appreciated property under § 311(b). However, § 852(b)(6) provides that § 311(b) “shall not apply” to certain RIC distributions. Specifically, § 311(b) does not apply to any distribution by a RIC to which part I of subchapter M applies, “if such distribution is in redemption of its stock upon the demand of the shareholder.”

Section 852(b)(6) does not affect the treatment of a redemption to the redeeming shareholder, which typically requires the shareholder to recognize any gain on the exchange. *See* §§ 302(a) and 1001(a). If the RIC shares are newly acquired and are redeemed for an amount equal to or that approximates the purchase price of the shares, the shareholder may recognize no or minimal gain or loss on the redemption. The shareholder takes a cost basis (rather than a transferred basis) in the property received that is generally equal to the fair market value of the RIC shares surrendered. *See* § 1012(a). The RIC is not required to reduce its basis in any assets by the amount of the unrecognized gain. Thus, gain inherent in the assets distributed in a § 852(b)(6) redemption is not recognized by either party to the exchange, and is not applied as an adjustment to the basis of any other property. The unrecognized gain attributable to the continuing shareholders is not affected and may effectively be recognized by them upon sale or other disposition of their RIC shares.

While traditional mutual funds redeem their shares at the demand of the shareholder, they have traditionally not distributed property in kind and instead generally issue and redeem their shares in exchange for cash. Shares of these mutual funds do not trade in the secondary market or on an exchange.

By contrast, shares of stock in an ETF trade on a public exchange. In addition, one or more financial institutions, each designated as an "authorized participant" with respect to an ETF, transact directly with the ETF to acquire large blocks of ETF shares (creation units). While the trading price of the ETF shares on the exchange may be affected by multiple factors, the purchase price for creation units is based directly on the net asset value (NAV) of the ETF.

Authorized participants also transact directly with the ETF to redeem ETF shares. When an authorized participant presents shares for redemption, the ETF distributes assets with a fair market value equal to the ETF's NAV allocable to the shares tendered by the authorized participant for redemption. The ETF determines the specific assets that it distributes in redemption. Often, the ETF distributes appreciated securities. Distributions of securities carried out in a manner that complies with § 852(b)(6) result in nonrecognition of realized gain or loss for the ETF under §§ 852(b)(6) and 311(a).

The Treasury Department and the IRS are aware that ETFs regularly engage in such creation and redemption transactions and take the position that distributions of securities as described above result in nonrecognition of gain or loss. Except to the extent discussed below, this notice does not address such distributions and is not intended to express a view regarding such distributions.

.02 *Transfers to controlled corporations in transactions intended to qualify under § 351.*

(1) *Background.*

Section 351 allows for tax deferral of built-in gain on assets that are transferred to a corporation in exchange for that corporation's stock, provided that certain requirements are met. Specifically, § 351(a) provides that no gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in that corporation, and immediately after the exchange, such person or persons are in control (as defined in § 368(c)) of the corporation.

However, § 351(e) provides that the general rule for nonrecognition of gain or loss under § 351(a) does not apply to the "transfer of property to an investment company." Section 1.351-1(c)(1) provides that a transfer of property will be considered to be a transfer to an investment company if: (i) the transfer results, directly or indirectly, in diversification of the transferors' interests, and (ii) the transferee is (A) a RIC, (B) a real estate investment trust, or (C) a corporation more than 80 percent of the value of whose assets consist of "stock and securities" within the meaning of § 351(e)(1)(B).[4]

Section 1.351-1(c)(5) provides that a transfer ordinarily will result in diversification of the transferors' interests if two or more persons transfer nonidentical assets to a corporation in the exchange. However, if there is only one transferor (or two or more transferors of identical assets) to a newly organized corporation, the transfer generally will not be treated as resulting in diversification. If a transfer is part of a plan to achieve diversification without recognition of gain, the original transfer will be treated as resulting in diversification.

Section 1.351-1(c)(6)(i) provides that a transfer of stocks and securities will not be treated as resulting in a diversification of the transferors' interests if each transferor transfers a diversified portfolio of stocks and securities. A portfolio of stock and

[4] The regulations under § 351 have not been updated to reflect changes made by § 1002 of the Taxpayer Relief Act of 1997 (Public Law 105-34, 111 Stat. 788, 909 (Aug. 5, 1997)).

securities is generally diversified if it meets the tests set forth in § 368(a)(2)(F)(ii)—that is (i) not more than 25 percent of the value of the total assets of the portfolio is invested in the stock and securities of any one issuer, and (ii) not more than 50 percent of the total value of the portfolio's assets is invested in the stock and securities of five or fewer issuers.

(2) *Section 351 conversion transactions*.

Some investment advisors are promoting a so-called "§ 351 conversion transaction" strategy to diversify investors' portfolios without the investors recognizing built-in gains in their securities. In a § 351 conversion transaction, as part of a plan, one or more investors transfer a portfolio of appreciated securities to a newly formed ETF. Each transferred portfolio satisfies the definition of a diversified portfolio for purposes of § 351(e). However, some or all of the securities in the transferred portfolio do not align with the ETF's contemplated securities portfolio or investment thesis following the completion of the planned transactions, or the transferred portfolio may have an overconcentration of one or more securities compared to the ETF's contemplated securities portfolio following the completion of the planned transactions.

Consequently, pursuant to the plan that includes the transfer of securities by the investor(s) to the ETF, the following two transactions take place. First, the ETF issues one or more creation units to an authorized participant in exchange for securities that are consistent with the ETF's investment thesis or cash that the ETF intends to use to acquire such securities. Second, the ETF redeems the creation unit(s), in a transaction intended to qualify under § 852(b)(6), in exchange for securities that the investor(s) transferred to the ETF. The securities contributed by the authorized participant are expected to result in the ETF owning a materially different portfolio of securities consistent with the ETF's investment thesis, or the cash contributed by the authorized participant would be used by the ETF to acquire securities that result in the ETF owning a materially different portfolio of securities consistent with the ETF's investment thesis. In many cases, these transactions may take place shortly after the contribution of the transferred portfolio to the ETF. As a result of the planned transactions, investors expect to avoid recognition of the built-in gains in their securities at the time of the purported § 351 transaction while effectively exchanging those securities for an interest in an ETF with a materially different portfolio of securities. In sum, transactions purporting to be governed by §§ 351 and 852(b)(6) are being combined as part of a plan to achieve a result that neither provision was designed to produce.

Concurrently with this notice, the Treasury Department and the IRS are issuing Rev. Rul. 2026-20, which provides that certain contributions of appreciated securities by investors to an ETF as part of a plan involving a distribution of some or all of those securities by the ETF pursuant to a redemption shortly thereafter are properly characterized as taxable exchanges under § 1001 by the contributing investors with the authorized participant rather than a contribution to the ETF that qualifies as a § 351 transaction. The Treasury Department and the IRS are considering additional guidance to address § 351 conversion transactions.

This notice does not address, and expresses no view regarding, transactions in which a § 351 transaction is used to seed a newly established ETF with assets that are consistent with the ETF's investment thesis and that are intended and expected to be retained by the ETF absent a substantial change in circumstances (including an unexpected change in market or business conditions).

.03 *Transfers to partnerships in connection with a § 351 conversion transaction*.

(1) *Background.*

Similar to § 351, § 721(a) generally allows for tax deferral of built-in gain in assets that are transferred to a partnership in exchange for interests in the partnership. Specifically, § 721(a) provides that no gain or loss will be recognized by a partnership or any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) provides that the general rule for nonrecognition of gain or loss under § 721(a) does not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of § 351(e)) if the partnership were incorporated. Therefore, the provisions of § 351(e) and the § 351(e) regulations apply in determining whether gain is recognized under § 721(b) on a contribution of built-in gain property to a partnership.

(2) *Partnership exchange funds*.

The § 351 conversion transaction described in section 2.02(2) of this notice depends upon the investors transferring to an ETF a portfolio that is diversified for purposes of § 351(e). The Treasury Department and the IRS are aware that certain investment advisors are promoting a related “partnership variation” strategy to investors whose portfolio of securities with built-in gains is not diversified for purposes of § 351(e). In the partnership variation, as part of a plan, investors contribute one or more securities with built-in gains to a partnership that invests at least 20 percent of the value of the partnership’s assets in property that is not stocks or securities (within the meaning of

§ 351(e)(1)(B)), with the intention that the partnership would not be treated as an investment company under § 351(e) if it were incorporated.[5] As a result, the investors take the position that § 721(b) does not apply and, therefore, that the transfers to the partnership qualify for nonrecognition treatment under § 721(a).

Although the investors individually will not have contributed a diversified portfolio of securities to the partnership, the advisor will ensure that the partnership owns a portfolio of securities that is diversified for purposes of § 351(e). As part of the same plan, the partnership subsequently engages in a § 351 conversion transaction as described in section 2.02(2) of this notice. The investors purportedly avoid recognition of the built-in gains in their securities while effectively exchanging those securities for an indirect interest in an ETF with a materially different portfolio of securities. In these transactions, §§ 351, 721 and 852(b)(6) are being applied to a series of planned transactions to achieve a result that these provisions were not intended to produce.

As described above, the Treasury Department and the IRS are issuing Rev. Rul. 2026-20 concurrently with this notice to address § 351 conversion transactions. The Treasury Department and the IRS continue to consider other guidance that would provide that the contributions to partnerships described above do not qualify for nonrecognition of gain or loss or otherwise may be recharacterized in a manner that reflects the proper substance of the underlying transactions for federal income tax purposes. This notice does not address other transactions involving exchange funds, and this notice is not intended to express a view regarding such transactions.

.04 *Box spread funds*.

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[5] Such a partnership may be referred to as an “exchange fund.”

Some ETFs are taking the position that § 852(b)(6) applies to redemption transactions that occur as part of a strategy to provide the type of stable time-value-of-money return ordinarily associated with investment in government obligations without current income recognition. Such ETFs generate their returns using a "box spread," that is, a combination of four options on the same underlying property that, in the aggregate, produce a return similar to a short-term interest rate.

The ETF enters into the box spread with options that are not § 1256 contracts.[6] Before the options in the box spread that have unrealized gain for federal income tax purposes expire, the ETF separates the components of the box spread using a distribution intended to qualify for nonrecognition under § 852(b)(6). More specifically, (i) the ETF issues a creation unit to an authorized participant in exchange for cash or property, and (ii) the ETF distributes the options that have unrealized gain in redemption of the creation unit in a transaction intended to qualify under § 852(b)(6). As a result, the ETF purportedly avoids recognition of any income or gain from the box spread, and investors purportedly recognize no current income although they economically benefit from a return consistent with a short-term interest rate. The ETF generally reports to its shareholders no dividends (including capital gain dividends) or undistributed capital gains to be included by shareholders. As a consequence, shareholders generally include no income currently. Because the box spreads increase the value of the ETF's portfolio, and the value of its shares, shareholders generally recognize capital gain (short-term or long-term capital gain, depending upon their respective holding periods)

[6] Non-§ 1256 contracts are used because the distribution of options that are § 1256 contracts would be a termination or transfer giving rise to recognized gain or loss under § 1256(c)(1).

upon a sale or disposition of their shares in an amount that corresponds to the ETF's income from the box spreads.

A similar transaction involves an ETF that engages in both a box spread transaction and a separate transaction comprised of offsetting positions that constitute a straddle within the meaning of § 1092(c)(1) and distributes the positions in the straddle that have unrealized gain for federal income tax purposes. The ETF takes the position that it can deduct the loss on the remaining straddle positions notwithstanding that the offsetting gain is never recognized, and that such loss is available to offset income from the box spread (or any other income recognized by the ETF).

This notice does not address other transactions involving box spreads, and this notice is not intended to express a view regarding such transactions.

.05 *Record date strategies*.

Some equity ETFs are investing in other equity ETFs (acquired ETFs) and taking the position under § 852(b)(6) that recognition of dividend income can be avoided by making a redemption distribution of the stock of the acquired ETF prior to the record date. For example, an ETF (parent ETF) may seek a return that tracks an index by investing in one or more acquired ETFs that track the same index. The acquired ETFs pay dividends at times that vary with their taxable years or other factors. The trading price of the acquired ETF generally reflects the value of its expected dividend payments (reflecting the dividends paid by the issuers of the securities held by the acquired ETF). Shortly before the record date for payment of a dividend by an acquired ETF, (i) the parent ETF issues a creation unit to an authorized participant in exchange for property such as cash or shares of a different ETF that tracks the same index, and (ii) the parent

ETF subsequently distributes to the authorized participant the shares of the acquired ETF in redemption of the parent ETF shares. If the property contributed by the authorized participant is cash, the parent ETF invests in shares of a different ETF that tracks the same index. The parent ETF takes the position that it avoids recognition of dividend income, and parent ETF shareholders take the position that they recognize no income or capital gain until they dispose of their parent ETF shares, at which time they recognize capital gain or loss based on the difference between their basis in the parent ETF shares and the amount realized on disposition. Throughout the transactions, the parent ETF generally maintains its exposure to the same underlying index of stock or securities. The purpose of the disposition of one acquired ETF and the acquisition of a replacement acquired ETF is to eliminate taxable dividend income without any material change to the economic characteristics of the assets of the parent ETF. Similar transactions may take place with ETFs that invest in bonds.

This notice does not address transactions involving ETFs that invest in other ETFs that track different indices, and this notice is not intended to express a view regarding such transactions.

.06 *RIC income test avoidance*.

Section 851(b)(2) provides an income test for qualification as a RIC (RIC income test). To be treated as a RIC for a taxable year, at least 90 percent of a corporation's gross income must be: (i) dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in § 2(a)(36) of the Investment Company Act of 1940, as amended) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies; and (ii) net income derived from an interest in a qualified publicly traded partnership (as defined in § 852(h)).

Some ETFs are taking the position that § 852(b)(6) permits them to circumvent the income test in § 851(b)(2) by avoiding the recognition of gains with respect to distributed assets that would not be qualifying income. The ETFs invest directly in assets that, upon a sale or exchange, would produce gains not described in § 851(b)(2). For example, the ETF might hold positions in commodities or digital assets, either by holding those assets directly or by investing in a grantor trust that holds these assets. These ETFs avoid recognizing gain that would be non-qualifying income by distributing the assets that would produce the gain in redemption of creation units. Specifically, (i) the ETF issues a creation unit to an authorized participant in exchange for cash or other property specified by the ETF, and (ii) the ETF distributes to the authorized participant the relevant asset in redemption of the creation unit in a transaction intended to qualify under § 852(b)(6). The ETF takes the position that any gain that is realized but not recognized as a result of § 852(b)(6) is not taken into account for purposes of the RIC income test. The strategy purportedly would allow the ETF to limit its gross income that is subject to the requirements of § 851(b)(2) without regard to the ETF's economic income.

This notice does not address other forms of investment in assets that would give rise to non-qualifying income, such as investments in such assets through a controlled foreign corporation within the meaning of section 957(a), and this notice is not intended to express a view regarding such investments.

SECTION 3. STRATEGIES USED BY TAX-AWARE FUNDS

.01 *Background*.

The Treasury Department and the IRS are aware of several multi-position strategies that so-called “tax-aware” funds appear to use based on technical differences among economically similar financial products or payments, or timing and identification rules, to create a pattern of generating capital gain and ordinary loss. In many of these strategies, the character of resulting federal income tax items is manipulated depending on which position or “leg” of the multi-position strategy is terminated, which election or identification is made, or which federal income tax rule applies. The purported result can be ordinary losses that offset unrelated ordinary income, paired with capital gains that are taxed at lower rates, deferred, or otherwise absorbed. These tax-aware fund strategies tend to be in the form of an investment partnership or a separately managed account overseen by an investment manager, and references to “tax-aware funds” in this section 3 refer to both of those alternatives. Certain of these tax-aware funds appear to be primarily tax-motivated rather than being directed toward generating an economic return from genuine investment activity. Others may carry out bona fide and profitable investment activity but also engage in the transactions described in this section 3.

The Treasury Department and the IRS acknowledge that certain long-standing, well-established techniques may be used to reduce federal income taxes in a manner consistent with the intent of Congress. For example, a taxpayer desiring exposure to a particular financial index comprised of equity securities may invest directly in the underlying securities and may choose to sell the securities that have unrealized losses at year-end and retain securities that have unrealized gain at year-end. The labelling of a strategy as "tax-aware" or "tax-advantaged" does not in and of itself represent cause for concern. This section 3 describes strategies of particular interest to the Treasury Department and the IRS, including strategies that seek to create a pattern of generating capital gain and ordinary loss in similar amounts from economically offsetting transactions or that seek to achieve effective character electivity by using certain elections in ways that are inconsistent with their purpose.

.02 *Section 1092(a)(2) identified straddles with mixed character*.

(1) *Background*.

Section 988(a)(1)(A) provides that certain transactions involving foreign currency give rise to gain or loss that is ordinary in character. This rule generally applies to foreign currency derivatives, such as forward contracts. However, regulated futures contracts that would be marked to market under § 1256 if held on the last day of the taxable year are not subject to this rule. *See* § 988(c)(1)(B)(iii) and (D)(i). Under § 1256(a)(3), such contracts give rise to capital gain or loss (60 percent long-term/40 percent short-term).

Section 1092 provides rules primarily intended to defer the recognition of losses from financial instruments or positions if a taxpayer holds an offsetting position, or successor position, with unrecognized gain. Generally, under § 1092(a)(1), a realized loss on a straddle position may not be taken into account to the extent of the unrecognized gain at the close of the taxable year with respect to any position that was an offsetting position, regardless of whether the position that gave rise to the unrealized gain is held by the taxpayer at the close of the taxable year. A related provision of the

Code is intended to prevent taxpayers from using straddles to generate offsetting ordinary expenses and capital gain. *See* § 263(g).

Section 1092(a)(2) permits a taxpayer to make an identification of a straddle (identified straddle), and in the case of any straddle that is an identified straddle, loss from a position in the straddle is taken into account solely by increasing the basis of offsetting positions in the straddle. The identified straddle rules were enacted to provide certainty to taxpayers as to which positions are treated as part of a straddle by permitting taxpayers to identify offsetting positions of a straddle, subject to certain conditions. Like the general straddle rules, the identified straddle rules were intended as timing rules addressing selective loss recognition transactions.

(2) *Identified straddles used to convert character*.

The Treasury Department and the IRS are aware of a strategy involving identified straddles that include both a position that gives rise to capital gain or loss and an offsetting position that gives rise to ordinary income or loss. This strategy is being used to generate gross capital gain and ordinary loss from offsetting positions, in a manner inconsistent with congressional intent.[7]

One example of this strategy involves an investment fund entering into pairs of foreign currency contracts that are long and short the same foreign currency, consisting of (i) a forward contract giving rise to ordinary income or loss under § 988(a)(1), and (ii) a futures contract giving rise to 60 percent long-term capital gain or loss and 40 percent short-term capital gain or loss under § 1256(a)(3). These contracts constitute a

[7] Conference Report for the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), H.R. Rep. No. 100-1104, vol. II, at 193–94 (1988).

straddle under § 1092(c)(1).[8] The investment fund identifies the contracts as an identified straddle pursuant to § 1092(a)(2).

Regardless of the performance of the contracts, the investment fund terminates the futures contract first. The investment fund may take steps intended to ensure that the futures contract is treated as terminated first for federal income tax purposes even if it economically terminates its risk position in the forward contract earlier. If the futures contract is in a gain position, the investment fund recognizes capital gain on the futures contract and then a corresponding ordinary loss upon the settlement of the forward contract. If the futures contract is in a loss position, the investment fund takes the position that the loss from the termination of the futures contract is capitalized into the basis of the forward contract under § 1092(a)(2)(A), reducing the ordinary income (or producing an ordinary loss) on the forward contract at settlement. As a result, the investment fund takes the position that, in the former case, it recognizes gross capital gain (60 percent long-term and 40 percent short-term) and gross ordinary loss from the offsetting positions, and in the latter case it recognizes a small amount of net ordinary income or loss.

The Treasury Department and the IRS are also aware of a similar strategy involving § 1092(a)(2) identified straddles for which the positions in the identified straddle consist of a notional principal contract (NPC) that is an equity index swap and a futures contract on the same equity index.

This notice does not address the use of identified straddles in transactions that give

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[8] Section 1092 does not apply if all of the offsetting positions in a straddle consist of § 1256 contracts, but this rule does not apply to positions in an identified straddle.

rise to consistent character and holding period results regardless of whether a position in the straddle has gain or loss, and this notice is not intended to express a view regarding such investments.

.03 *Same-day acquisitions and dispositions of foreign currency forward contracts*.

(1) *Background*.

Section 988(a)(1)(B) provides an election to treat any foreign currency gain or loss as capital gain or loss to the extent it is attributable to a forward contract (or other specified contract) that is a capital asset in the taxpayer's hands and not part of a straddle. The election is available only if the taxpayer identifies the transaction by a specified time, which under current law is the close of the day on which the transaction is entered into. This election was intended to allow taxpayers that trade foreign currency through both regulated futures contracts (which generally give rise to capital gain or loss) and forward contracts (which generally give rise to ordinary gain or loss) to obtain consistent capital treatment for gains and losses from those contracts.

(2) *Section 988(a)(1)(B) elections used to obtain inconsistent character*.

The Treasury Department and the IRS are aware of a strategy involving an investment fund that enters into foreign currency forward contracts that expire or are disposed of or terminated for federal income tax purposes on the same day they are entered into. As described in section 3.03(1) of this notice, by default, these foreign currency forward contracts give rise to ordinary income or loss under § 988(a)(1)(A). However, after the investment fund has completed its trading for the day, the investment fund elects the application of § 988(a)(1)(B) for forward contracts that expire or are disposed of or terminated at a gain on that day in order for the gain to be capital. No election is made with respect to forward contracts that expire or are disposed of or terminated at a loss. The investment fund decides whether to elect the application of § 988(a)(1)(B) at a time when the investment fund knows whether the election is advantageous. In other words, the investment fund has the benefit of hindsight at the time that it makes the election. Contrary to the intent underlying the § 988(a)(1)(B) election, the tax-motivated strategy purports to produce beneficial amounts of capital gain and ordinary loss to investors by electing different character for federal income tax items resulting from identical financial instruments. These ordinary losses may then be available to offset unrelated ordinary income.

.04 *Selective NPC terminations used to obtain inconsistent character*.

(1) *Background*.

Section 1.446-3 provides federal income tax accounting rules for taking into account payments on NPCs, often referred to as swaps. Those rules characterize NPC payments as periodic payments, nonperiodic payments, and termination payments in § 1.446-3(e), (f), and (h), respectively. Periodic and nonperiodic payments are payments made pursuant to the terms of the NPC and are required to be accrued on a daily ratable basis pursuant to § 1.446-3(e)(2) and (f)(2), respectively. A termination payment, defined in § 1.446-3(h)(1) as a payment made or received to extinguish or assign all or a proportionate part of the remaining rights and obligations of any party under an NPC, is required to be taken into account in the year the NPC is extinguished, assigned or exchanged rather than being subject to accrual on a daily ratable basis. These rules govern the timing of income and expense from NPCs in a manner that is intended to clearly reflect income.

Section 1234A(a) generally provides that gain or loss attributable to the cancellation, lapse, expiration, or other termination of a right or obligation with respect to property that is (or, on acquisition, would be) a capital asset in the hands of the taxpayer is capital gain or loss. Section 1234A was enacted to prevent taxpayers from extinguishing a financial contract in a loss position in order to claim an ordinary loss, due to the absence of a sale or exchange, but selling a financial contract in a gain position to claim a capital gain.[9] In other words, § 1234A was intended to ensure that gains and losses from transactions economically equivalent to the sale or exchange of a capital asset obtain similar treatment.

Under proposed regulations issued in 2004,[10] gain or loss arising from a termination payment, as defined in § 1.446-3(h)(1), would be treated as gain or loss from a termination of the NPC, generally resulting in treatment of such gain or loss as capital under § 1234A. These proposed regulations also set forth a methodology for accruing nonperiodic payments that are contingent in amount, such as a final nonperiodic payment under an NPC that is an "equity swap" for which the final nonperiodic payment is determined by reference to the value of stock.

The NPC rules and proposed regulations were devised with the intent that periodic and nonperiodic payments on an NPC would be accrued and give rise to ordinary income and expense, like other typical periodic payments such as interest or rent, while payments made or received in consideration of the disposition of an NPC would give

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[9] Senate Finance Committee Report on the Economic Recovery Tax Act of 1981, S. Rep. No. 97-144, at 170-71 (1981).

[10] Notice of proposed rulemaking and notice of public hearing (REG-166012-02) titled *Notional Principal Contracts; Contingent Nonperiodic Payments*, published in the *Federal Register* (69 F.R. 8886; Feb. 26, 2004).

rise to capital gain or loss, like other payments made in exchange for a capital asset.

(2) *Selective NPC termination strategy*.

The Treasury Department and the IRS are aware of a strategy involving an investment fund that is a trader for federal income tax purposes (but does not make a § 475(f) trader election) that enters into multiple NPCs as part of its trading strategy. The NPCs may be long or short positions with respect to different underlying assets or indices. The NPCs are typically short-term, in some cases very short-term (for example, one week). Each NPC calls for one or more periodic or nonperiodic payments, and one or more of these payments is contingent on the performance of an underlying asset such as stock. In some fact patterns a contingent payment is due at maturity and reflects the change in value of underlying stock, and in others contingent payments reflecting changes in the value of the underlying stock are paid periodically. In certain cases, one or more periodic payments are added solely to qualify the derivative contract as an NPC in order to claim the benefit of the strategy described in this section 3.04(2). None of the NPCs at issue constitutes a component of a straddle under § 1092(c)(1). The investment fund does not take into account any amount with respect to the contingent payment(s) until payment, disposition or maturity but instead takes the position that the contingent payment(s) result in the recognition of ordinary income or expense when received or paid.

If a particular NPC has appreciated in value, the investment fund terminates or otherwise disposes of the NPC shortly before a scheduled payment date and receives a payment, which in the event of a termination is from the same party obligated to make the scheduled payment. The payment may be economically attributable primarily to the value of the underlying equity, which would ordinarily also be the primary economic factor determining the amount of the scheduled payment. The investment fund takes the position that a payment received upon termination is attributable to the termination or extinguishment of the NPC for purposes of § 1.446-3(h) and § 1234A, and that the resulting income is capital in character. That is, the investment fund takes the position that none of the payment substitutes for (and has the same character as) the scheduled payment expected to be received and instead all of the payment is a termination payment under § 1.446-3(h). With regard to the NPCs in a loss position, the investment fund holds the NPC until the scheduled payment or expiration date and takes the position that the investment fund recognizes ordinary expense from the payment.

An investment fund pursuing this strategy purports to generate gross capital gain and gross ordinary losses, which provides valuable federal income tax benefits to investors, using selectivity to achieve different character for similar payments on identical financial instruments, contrary to the purposes of the timing and character rules described in section 3.04(1) of this notice.

SECTION 4. REQUEST FOR COMMENTS

.01 *Request for comments*.

The Treasury Department and the IRS request additional details regarding the transactions described in this notice giving rise to unintended tax benefits (subject transactions), as well as similar transactions, and comments on their appropriate federal income tax treatment. In particular, the Treasury Department and the IRS request comments that address the following questions:

(1) Is the description of the subject transactions accurate? Are there additional

facts or considerations of which the Treasury Department and the IRS should be aware in determining the appropriate federal income tax treatment of the subject transactions?

(2) Are there transactions that appear to be similar to the subject transactions but have different facts or different economics that warrant different federal income tax treatment than the subject transactions? If so, what are the crucial differences between those transactions and the subject transactions?

(3) What future guidance would commenters suggest to address the concerns discussed in this notice and not addressed by Rev. Rul. 2026-20? What is the appropriate scope of such guidance so that it does not adversely affect well-established market practice that is consistent with the intent of Congress?

(4) Are there other investment fund strategies that market participants are pursuing that may be viewed as producing unintended federal income tax results?

.02 *Procedures for submitting comments*.

(1) *Deadline*.

Written comments should be submitted by October 28, 2026. Consideration also will be given to any written comment submitted after October 28, 2026, though such comments may not be considered in the development of any forthcoming guidance if such consideration would delay the issuance of the forthcoming guidance.

(2) *Form and manner*.

The subject line for the comments should include a reference to Notice 2026-62. All commenters are strongly encouraged to submit comments electronically. Comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at *www.regulations.gov* (type IRS-2026-1255 in the search field on the *www.regulations.gov* homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:01:PR (Notice 2026-62), Room 5503, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) *Publication of comments*.

The Treasury Department and the IRS will publish for public availability all comments submitted electronically or on paper to its public docket on *www.regulations.gov*.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Justin R. Karlin of the Office of the Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the Treasury Department and the IRS participated in its development. For further information on the transactions described in this notice, contact Mr. Karlin at (202) 317-6842 (not a toll-free number).