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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **INFO 2001-0218**
Release Date: 9/28/2001
UIL: 1091.00-00

August 16, 2001



Dear [REDACTED]:

This responds to your letter dated June 5, 2001, requesting guidance on the application of the wash sales rule under section 1091 of the Internal Revenue Code to certain day traders. You have asked about the relationship between the exemption from the wash sales rule set forth in section 1091(a) and the exemption set forth in section 1.1091-1(a) of the Income Tax Regulations.

Section 1091 applies to a transaction in which a taxpayer sells stock or securities at a tax loss, but purchases or enters into a contract or option to acquire substantially identical stock or securities within thirty days before or after the sale. Section 1091 generally applies to all taxpayers, including individuals, corporations, banks, trust companies, life insurance companies, trusts, and estates. Section 1091(a) provides, however, that the wash sales rule does not apply to losses incurred by a dealer, provided the losses were sustained in a transaction incurred in the dealer's ordinary course of business. Therefore, a taxpayer must satisfy two requirements to be exempted under section 1091(a) from the wash sales rule. First, the taxpayer must be a dealer, and second, the losses must have been sustained in the dealer's ordinary course of business.

Section 1.1091-1(a) appears to provide an additional exemption from the application of the wash sales rule for taxpayers who are not dealers. Section 1.1091-1(a) provides that the wash sales rule does not apply to (1) a non-corporate taxpayer if the sale or other disposition of stock or securities is made in connection with the taxpayer's trade or business or to (2) a corporation that is a dealer in securities if the sale or other disposition of stock or securities is made in the ordinary course of its business as a dealer.

Section 1.1091-1(a), however, was promulgated before the enactment of the Deficit Reduction Act of 1984 (Public Law 98-369). The Deficit Reduction Act of 1984 amended section 1091 by striking language which had included noncorporate traders as among those exempted from section 1091 application. The consequent effect was to limit the exemption under section 1091(a) from the application of the wash sales rule to dealers. This change applied to those transactions taking place after December 31, 1984. Not all regulations are amended to reflect law changes, and section 1.1091-1(a) does not reflect this subsequent change in statutory language.

Therefore, only a dealer engaging in the ordinary course of business is exempt under section 1091(a) from the wash sales rule of section 1091. A trader is subject to section 1091 unless another section of the Code precludes the application of the wash sales rule. The only exception is that noncorporate traders are not subject to the wash sales rule for transactions entered into prior to January 1, 1985.

We hope this information is helpful. If we can be of any further assistance, please call me at (202) 622-3950 or Shannon McCormack at (202) 622-3248.

Sincerely yours,

Alice M. Bennett
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)