

section 1234(b) and § 1.1234-3. For special rules for grantors of straddles applicable to certain options granted on or before September 1, 1976, see § 1.1234-2.

(c) *Certain options to sell property at a fixed price.* Section 1234 does not apply to a loss on the failure to exercise an option to sell property at a fixed price which is acquired on the same day on which the property identified as intended to be used in exercising the option is acquired. Such a loss is not recognized, but the cost of the option is added to the basis of the property with which it is identified. See section 1233(c) and the regulations thereunder.

(d) *Dealers in options to buy or sell.* Any gain or loss realized by a dealer in options from the sale or exchange or an option to buy or sell property is considered ordinary income or loss under paragraph (a)(3) of this section. A dealer in options to buy or sell property is considered a dealer in the property subject to the option.

(e) *Other exceptions.* Section 1234 does not apply to gain resulting from the sale or exchange of an option:

(1) To the extent that the gain is in the nature of compensation (see sections 61 and 421, and the regulations thereunder, relating to employee stock options);

(2) If the option is treated as section 306 stock (see section 306 and the regulations thereunder, relating to dispositions of certain stock); or

(3) To the extent that the gain is a distribution of earnings or profits taxable as a dividend (see section 301 and the regulations thereunder, relating to distributions of property).

(4) Acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such option is a capital asset (whether or not the property to which the option relates is, or would be if acquired by the taxpayer, a capital asset in the hands of the taxpayer).

(f) *Limitations on effect of section.* Losses to which section 1234 applies are subject to the limitations on losses under sections 165(c) and 1211 when applicable. Section 1234 does not permit the deduction of any loss which is disallowed under any other provision of law. In addition, section 1234 does not apply to an option to lease property,

but does apply to an option to buy or sell a lease. Thus, an option to obtain all the right, title, and interest of a lessee in leased property is subject to the provisions of section 1234, but an option to obtain a sublease from the lessee is not. Furthermore, if section 1234 applies to an option to buy or sell a lease, it is the character the lease itself, if acquired, would have in the hands of the taxpayer, and not the character of the property leased, which determines the treatment of gain or loss experienced by the taxpayer with respect to such an option.

(g) *Examples.* The rules set forth in this section may be illustrated by the following examples:

*Example 1.* A taxpayer is considering buying a new house for his residence and acquires an option to buy a certain house at a fixed price. Although the property goes up in value, the taxpayer decides he does not want the house for his residence and sells the option for more than he paid for it. The gain which taxpayer realized is a capital gain since the property, if acquired, would have been a capital asset in his hands.

*Example 2.* Assume the same facts as in example (1), except that the property goes down in value, and the taxpayer decides not to purchase the house. He sells the option at a loss. While this is a capital loss under section 1234, it is not a deductible loss because of the provisions of section 165(c).

*Example 3.* A dealer in industrial property acquires an option to buy an industrial site and fails to exercise the option. The loss is an ordinary loss since he would have held the property for sale to customers in the ordinary course of his trade or business if he had acquired it.

[T.D. 6500, 25 FR 12013, Nov. 26, 1960, as amended by T.D. 7652, 44 FR 62282, Oct. 30, 1979]

**§ 1.1234-2 Special rule for grantors of straddles applicable to certain options granted on or before September 1, 1976.**

(a) *In general.* Section 1234(c)(1) provides a special rule applicable in the case of gain on the lapse of an option granted by the taxpayer as part of a straddle. In such a case, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) on the day that the option expired. Thus,

such gain shall be treated as a short-term capital gain, as defined in section 1222(1). Section 1234(c)(1) does not apply to any person who holds securities (including options to acquire or sell securities) for sale to customers in the ordinary course of his trade or business.

(b) *Definitions.* The following definitions apply for purposes of section 1234(c) and this section.

(1) *Straddle.* The term *straddle* means a simultaneously granted combination of an option to buy (i.e., a *call*) and an option to sell (i.e., a *put*) the same quantity of a security at the same price during the same period of time.

(2) *Security.* The term *security* has the meaning assigned to such term by section 1236(c) and the regulations thereunder. Thus, for example, the term *security* does not include commodity futures.

(3) *Grantor.* The term *grantor* means the writer or issuer of the option contracts making up the straddle.

(4) *Multiple option.* The term *multiple option* means a simultaneously granted combination of an option to buy plus an option to sell plus one or more additional options to buy or sell a security.

(c) *Special rules in the case of a multiple option.* (1) If, in the case of a multiple option, the number of the options to sell and the number of the options to buy are the same and if the terms of all of the options are identical (as to the quantity of the security, price, and period of time), then each of the options contained in the multiple option shall be deemed to be a component of a straddle for purposes of section 1234(c)(1) and paragraph (a) of this section.

(2) If, in the case of a multiple option, the number of the options to sell and the number of the options to buy are not the same or if the terms of all of the options are not identical (as to the quantity of the security, price, and period of time), then section 1234(c)(1) applies to gain on the lapse of an option granted as part of the multiple option only if:

(i) The grantor of the multiple option identifies the two options which comprise each straddle contained in the multiple option in the manner prescribed in subparagraph (3) of this paragraph; or

(ii) It is clear from the facts and circumstances that the lapsed option was part of a straddle. See example (6) of paragraph (f) of this section. A multiple option to which this subdivision applies may not be regarded as consisting of a number of straddles which exceeds the lesser of the options to sell or the options to buy as the case may be. For example, if a multiple option of five puts and four calls is granted it may not be regarded as consisting of more than four straddles, although the particular facts and circumstances could dictate that the option consists of less than four straddles.

(3) The identification required under subparagraph (2)(i) of this paragraph shall be made by the grantor indicating in his records, to the extent feasible, the individual serial number of, or other characteristic symbol imprinted upon, each of the two individual options which comprise the straddle, or by adopting any other method of identification satisfactory to the Commissioner. Such identification must be made before the expiration of the 15th day after the day on which the multiple option is granted. The preceding sentence shall apply only with respect to multiple options granted after January 24, 1972. In computing the 15-day period prescribed by this paragraph, the first day of such period is the day following the day on which the multiple option is granted.

(d) *Allocation of premium.* The allocation of a premium received for a straddle or a multiple option between or among the component options thereof shall be made on the basis of the relative market value of such component options at the time of their issuance or on any other reasonable and consistently applied basis which is acceptable to the Commissioner.

(e) *Effective date*—(1) *In general.* This section, relating to special rules for grantors of straddles, shall apply only with respect to straddle transactions entered into after January 25, 1965, and before September 2, 1976.

(2) *Special rule.* For a special rule with respect to the identification of a straddle granted as part of a multiple option, see paragraph (c).

(f) *Illustrations.* The application of section 1234(c) and this section may be illustrated by the following examples:

*Example 1.* On February 1, 1971, taxpayer A, who files his income tax returns on a calendar year basis, issues a straddle for 100 shares of X Corporation stock and receives a premium of \$1,000. The options comprising the straddle were to expire on August 10, 1971. A has allocated \$450 (45 percent of \$1,000) of the premium to the put and \$550 (55 percent of \$1,000) to the call. On March 1, 1971, B, the holder of the put, exercises his option. C, the holder of the call, fails to exercise his option prior to its expiration. As a result of C's failure to exercise his option, A realizes a short-term capital gain of \$550 (that part of the premium allocated to the call) on August 10, 1971.

*Example 2.* Assume the same facts as in example (1), except that C exercises his call on March 1, 1971, and B fails to exercise his put prior to its expiration. As a result of B's failure to exercise his option, A realizes a short-term capital gain of \$450 (that part of the premium allocated to the put) on August 10, 1971.

*Example 3.* Assume the same facts as in example (1), except that both B and C fail to exercise their respective options. As a result of the failure of B and C to exercise their options, A realizes short-term capital gains of \$1,000 (the premium for granting the straddle) on August 10, 1971.

*Example 4.* On March 1, 1971, taxpayer D issues a multiple option containing five puts and five calls. Each put and each call is for the same number of shares of Y Corporation stock, at the same price, and for the same period of time. Thus, each of the puts and calls is deemed to be a component part of a straddle. The puts and calls comprising the multiple option were to expire on September 10, 1971. All of the puts are exercised, and all of the calls lapse. As a result of the lapse of the calls, D realizes a short-term capital gain on September 10, 1971, in the amount of that part of the premium for the multiple option which is allocable to all of the calls.

*Example 5.* Assume the same facts as in example (4) except that one of the puts and two of the calls lapse and the remaining puts and calls are exercised. As a result, on September 10, 1971, D realizes a short-term capital gain in the amount of that part of the premium for the multiple option which is allocable to both of the lapsed calls and the lapsed put.

*Example 6.* On March 1, 1971, taxpayer E issues a multiple option containing five puts and four calls. Each put and call is for the same number of shares of Y Corporation stock at the same price and for the same period of time. E does not identify the puts and calls as parts of straddles in the manner prescribed in paragraph (c)(3) of this section.

However, because the terms of all of the puts and all of the calls are identical four of the puts and four of the calls are deemed to be a component part of a straddle. The puts and calls comprising the multiple option were to expire on September 10, 1971. Four of the puts are exercised and the four calls and one of the puts lapse. As a result, on September 10, 1971, E realizes short-term capital gain in the amount of that part of the premium for the multiple option which is allocable to the four lapsed calls and realizes ordinary income in the amount of that part of such premium which is allocable to the lapsed put. If E had identified four of the puts and four of the calls as constituting parts of straddles in the manner prescribed in paragraph (c)(3) of this section and the put that lapsed constituted part of a straddle, then the gain on the lapse of the put would also be short-term capital gain.

*Example 7.* Assume the same facts as in example (6) except that two of the puts are for Y Corporation stock at a price which is greater than that of the other puts and the other calls and that two of the calls expire on October 10, 1971. Additionally, assume that the put which lapses is at the lower price. The two puts offering the Y Corporation stock at the greater price and the two calls with the later expiration date cannot be deemed to be component parts of a straddle. Thus, only two of the puts and two of the calls are deemed to be a component part of a straddle. As a result, E realizes income as follows:

(i) On September 10, 1971, short-term capital gain in the amount of that part of the premium for the multiple option which is allocable to the two lapsed calls with the expiration date of September 10, 1971, and ordinary income in the amount of that part of such premium which is allocable to the lapsed put. If E had identified two of the puts at the lower price and the two calls with the expiration date of September 10, 1971, as constituting parts of straddles in the manner prescribed in paragraph (c)(3) of this section and if the put that lapsed was one of those identified as constituting a part of a straddle, then the gain on the lapse of that put would also be short-term capital gain.

(ii) On October 10, 1971, ordinary income in the amount of that part of the premium for the multiple option which is allocable to the lapsed calls with an expiration date of October 10, 1971.

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