ALSTON&BIRD

WWW.ALSTON.COM

Federal Tax ADVISORY ■

APRIL1, 2016

Mark to Market

In January 2016, the Sixth Circuit reversed the Tax Court and ruled for the taxpayer in *Wright v. Commissioner*, 809 F. 3d 877 (6th Cir. 2016). If the IRS agrees, the ruling means that foreign currency contracts that are options can be marked to market under Section 1256, at least in the Sixth Circuit. Taxpayers with accrued gains will be more upset about this than were the Wrights, who reported a loss.

The transaction at issue was a tax shelter that has been repeated over and over again since the 1960s: you buy some sort of offsetting financial positions that will reflect both a gain and a loss and you figure out a way to recognize the loss this year, as an ordinary loss, and the gain next year as a capital gain. The Wrights may have been even more optimistic: they may have planned to never report the gain because they gave the position with the gain to a charity, although they "kept" the $36 million they received for the written put with the loss.

The IRS "listed" this transaction in 2003, Notice 2003-81. At first the IRS went along with the current year loss recognition, but thought that the taxpayer also should report the gain in the current year, as short term. Both positions were options on foreign currencies. However, the IRS changed its mind and denied that foreign currency options were foreign currency contracts as defined in Section 1256 and so were not marked to market when given to a charity. Of course, normally a donation to a charity is not a recognition event.

The Tax Court agreed with the IRS that an option was not a foreign currency contract and denied the loss, but the Sixth Circuit reversed. It claimed that the statute is unambiguous and clearly includes options on currencies as subject to mark to market. Because the gain reporting was not before the court, the taxpayer won: loss but no gain reported for the year at issue.

The IRS faces a hard decision. It can seek review by the U.S. Supreme Court, but without a circuit split the Court is not likely to take the case. It can try to develop a split in the circuits, but that takes time and the appropriate cases may not be in the pipeline. What it should do is ask the Treasury to write the regulation that it could

have written over 20 years ago and make clear that options are not foreign currency contracts. But Treasury must have good reasons for not moving before now and so still may not move.

Meanwhile, taxpayers can probably take either position: foreign currency options are or are not subject to mark to market under Section 1256.

For additional information, call Jack Cummings at 919.862.2302.

If you would like to receive future *Federal Tax Advisories* electronically, please forward your contact information to **FederalTax.Advisory@alston.com**. Be sure to put "**subscribe**" in the subject line.

Click **here** for Alston & Bird's Tax Blog.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481
sam.kaywood@alston.com

Edward Tanenbaum
Co-Chair
212.210.9425
edward.tanenbaum@alston.com

George Abney
404.881.7980
george.abney@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Matthew Moseley
202.239.3828
matthew.moseley@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Stefanie E. Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Danny Reach
704.444.1272
danny.reach@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

ALSTON&BIRD

WWW.ALSTON.COM