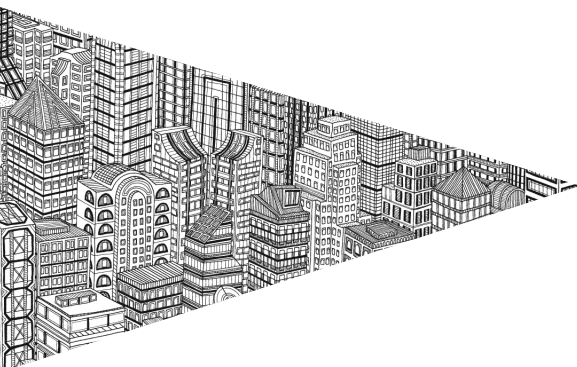


International Tax Alert



Updated 2011 Section 1256 qualified board or exchange list

Background

A taxpayer generally must mark to market transactions qualifying as Section 1256 contracts at the end of each tax year as if such transactions were sold for fair market value.¹ Subject to certain exceptions, any gain or loss on a Section 1256 contract is treated as 60% long-term capital gain or loss and 40% short-term capital gain or loss, regardless of how long the taxpayer actually held the contract.²

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Section 1256 contracts include (among other things) regulated futures contracts and non-equity options.³ A regulated futures contract is a contract that (1) is marked to market on a daily basis to determine the amount that the taxpayer must deposit to its margin account to cover losses, or the amount that it may withdraw from such account as a result of price changes during the day, and (2) is traded on or subject to the rules of a qualified board or exchange.⁴ A non-equity option is an option (other than an equity option) that is traded on or subject to the rules of a qualified board or exchange.⁵ A "qualified board or exchange" means: (1) a national securities exchange (2) a domestic board of trade, or (3) any other exchange, board of trade, or other market that the Secretary determines has rules adequate to carry out the purposes of Section 1256.⁶

Qualified board or exchange

Section 1256(g)(7) defines a qualified board or exchange (QBE) as (1) a national securities exchange which is registered with the Securities and Exchange Commission, (2) a domestic board of trade designated as a contract market by the Commodities Futures Trading Commission or (3) any

other market which the Secretary determines has rules adequate to carry out the purposes of the section. Below is a list of exchanges and boards that qualify as QBE's pursuant to Section 1256(g)(7).

A "national securities exchange" is a securities exchange that has registered with the SEC under Section 6 of the Securities Exchange Act of 1934 (the Exchange Act). There are currently fifteen securities exchanges registered with the SEC under Section 6(a) of the Exchange Act as national securities exchanges:

- ▶ NYSE Amex LLC (formerly the American Stock Exchange)
- ▶ BATS Exchange, Inc.
- ▶ BATS Y-Exchange, Inc.
- ▶ NASDAQ OMX BX, Inc. (formerly the Boston Stock Exchange)
- ▶ C2 Options Exchange, Incorporated
- ▶ Chicago Board Options Exchange, Incorporated
- ▶ Chicago Stock Exchange, Inc.
- ▶ EDGA Exchange, Inc.
- ▶ EDGX Exchange, Inc.
- ▶ International Securities Exchange, LLC
- ▶ The Nasdaq Stock Market LLC
- ▶ National Stock Exchange, Inc.
- ▶ New York Stock Exchange LLC
- ▶ NYSE Arca, Inc.
- ▶ NASDAQ OMX PHLX, Inc. (formerly Philadelphia Stock Exchange)

Certain exchanges are also registered with the SEC through a notice filing under Section 6(g) of the Exchange Act for the purpose of trading security futures. These exchanges also qualify as qualified boards or exchanges for purposes of Section 1256:

- ▶ Board of Trade of the City of Chicago, Inc.
- ▶ CBOE Futures Exchange, LLC
- ▶ Chicago Mercantile Exchange
- ▶ One Chicago, LLC
- ▶ The Island Futures Exchange, LLC
- ▶ NQLX LLC

The domestic boards of trade designated as contract markets by the Commodity Futures Trading Commission are as follows:

- ▶ Cantor Futures Exchange, L.P.
- ▶ CBOE Futures Exchange
- ▶ Chicago Board of Trade
- ▶ Chicago Climate Futures Exchange, LLC
- ▶ Chicago Mercantile Exchange
- ▶ Commodity Exchange, Inc.
- ▶ ELX Futures, L.P.
- ▶ Eris Exchange LLC
- ▶ Green Exchange, LLC
- ▶ ICE Futures U.S., Inc.
- ▶ Kansas City Board of Trade
- ▶ Minneapolis Grain Exchange
- ▶ NASDAQ OMX Futures Exchange, Inc.

- ▶ North American Derivative Exchange, Inc - formerly listed as HedgeStreet Inc.
- ▶ New York Mercantile Exchange
- ▶ NYSE Liffe US, LLC
- ▶ One Chicago LLC Futures Exchange
- ▶ The Trend Exchange, Inc.

Pursuant to Section 1256(g)(7)(C), Treasury has also determined that the following exchanges have rules adequate to carry out the purposes of Section 1256:

- ▶ International Futures Exchanges (Bermuda) Ltd. (Rev. Rul. 85-72),
- ▶ Mercantile Division of the Montreal Exchange (Rev. Rul. 86-7),
- ▶ Mutual Offset System - partnership between Chicago Mercantile Exchange and Singapore International Monetary Exchange Limited (Rev. Rul. 87-43),⁷
- ▶ ICE Futures (Rev. Rul. 2007-26),
- ▶ Dubai Mercantile Exchange (Rev. Rul. 2009-04),
- ▶ ICE Futures Canada (Rev. Rul. 2009-24),
- ▶ LIFFE (Rev. Rul. 2010-3).

Implications

In September 2011, Treasury released proposed regulations addressing the tax treatment of credit default swaps. The proposed regulations are an extension of the Dodd Frank Wall Street Reform and Consumer Protection Act (herein referred to as the Dodd-Frank Act).

The Dodd-Frank Act amended Section 1256 to explicitly exclude (for tax years beginning after 21 July 2010), any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement from the definition of a Section 1256 contract. This amendment was designed to prevent swaps cleared on an exchange from becoming subject to Section 1256.

The proposed regulations confirm that credit default swaps and other swaps will not be considered Section 1256 contracts. The preamble to the regulations, however, refers to changes to the Commodity Exchange Act (CEA) which may impact qualified boards or exchanges.

Under the proposed regulations, boards and exchanges may have to resubmit to the Commodities Futures Trade Commission (CFTC) for status as a designated contract market. If reapplication to the CFTC is required for designated contract market status, previously designated exchanges may no longer qualify and the revenue rulings specifically designating exchanges as having rules adequate to carry out the purposes of Section 1256 may be considered null and void. Thus, previously designated exchanges may have to resubmit to the Internal Revenue Service for a revenue ruling in order to be treated as a Section 1256 qualified board or exchange. Further guidance has not been issued on the Dodd-Frank Act. The Service has indicated it hopes

to publish guidance on the issue sometime in 2012. Ernst & Young, LLP will monitor the status of the proposed regulations. In the interim, clients are advised to continue marking to market contracts traded on the designated exchanges.

This list is subject to change on an ongoing basis as new qualified boards or exchanges are approved. Please note that this list is updated annually and does not immediately reflect such changes in the status of such qualified board or exchanges. Please contact the individuals listed below before adopting a position with respect to whether Section 1256 applies to a particular contract on a particular qualified board or exchange.

Endnotes

- 1 Section 1256(a)(1).
- 2 Section 1256(a)(1), (3).
- 3 Section 1256(g)(1), (3).
- 4 Section 1256(g)(1).
- 5 Section 1256(g)(3).
- 6 Section 1256(g)(7).
- 7 (1) Futures contracts or option contracts established under the System are treated as traded on or subject to the rules of the Origination Exchange for purposes of Section 1256 of the Code. Thus, contracts executed on the SIMEX and assumed by the CME under the System are treated as traded on or subject to the rules of a qualified board or exchange within the meaning of Section 1256(g)(1)(B) and Section 1256(g)(5) of the Code. By contrast, contracts executed on the CME and assumed by the SIMEX under the System are not treated as traded on or subject to the rules of a qualified board or exchange within the meaning of Section 1256(g)(1)(B) or Section 1256(g)(5).

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