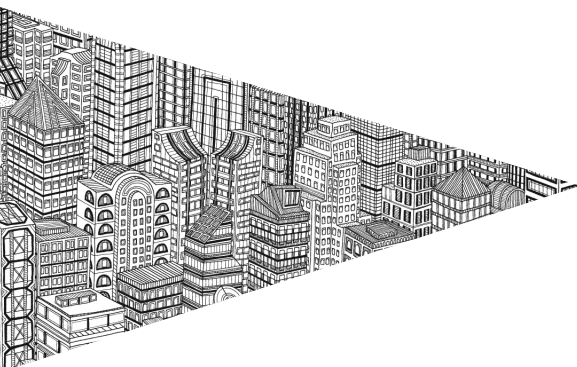


International Tax Alert



Updated list of foreign currency contracts subject to Section 1256

This International Tax Alert provides an updated list of foreign currencies that are traded in futures markets for purposes of determining whether a forward contract with respect to those currencies should be marked-to-market under Section 1256.¹ The list contained in this Alert updates the list of foreign currencies that was provided in an International Tax Alert dated 13 January 2011, Updated list of foreign currency contracts subject to Section 1256.

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Under Section 1256(a)(1), each Section 1256 contract held by a taxpayer at the close of the tax year must be marked-to-market. The term Section 1256 contract includes, among other things, any foreign currency contract.² The term foreign currency contract is defined under Section 1256(g)(2)(A) as a contract that:

1. Requires delivery of, or the settlement of which depends on the value of, a foreign currency that is a currency in which positions are also traded through regulated futures contracts;
2. Is traded in the interbank market; and
3. Is entered into at arm's length at a price determined by reference to the price in the interbank market.

The statutory definition is intended to describe the characteristics of bank forward contracts used for trading currency.

Although Section 1256 may govern the timing of gains and losses on foreign currency contracts, Section 988 generally governs the character of those contracts.³ Under Section 988, any gains or losses with respect to those forward contracts on foreign currency generally should be ordinary in character.⁴

The following is a list of currencies in which positions are traded through regulated futures contracts as of the date of this Alert:

1. Australian dollar
2. Brazilian real
3. British pound
4. Canadian dollar
5. Chinese renminbi
6. Columbian peso
7. Czech koruna
8. Euro
9. Hungarian forint
10. Israeli shekel
11. Japanese yen
12. Korean won
13. Mexico peso
14. New Zealand dollar
15. Norwegian krone
16. Polish zloty
17. Russian ruble
18. South African rand
19. Swedish krona
20. Swiss franc
21. Turkish lira

As described above, provided that the additional conditions described in Section 1256(g)(2)(A) are satisfied, forward contracts with respect to these foreign currencies should be marked-to-market under Section 1256(a)(1). In certain cases, however, an argument can be made that Section 1256 does not apply if the foreign currency is so thinly traded in regulated futures contracts that a market price is not available. Please, however, consult with one of the individuals listed before adopting the position that Section 1256 does not apply due to thin trading.

Generally, cross-currency forward contracts should also be marked-to-market under Section 1256 if such contracts are traded in the futures markets. Even if the specific contracts are not themselves traded, if each of the underlying currencies to a particular contract is individually traded in the markets, cross-currency forward contracts made up of those currencies may also be subject to Section 1256(a).⁵ If only one leg of a cross-currency forward contract is traded in regulated futures contracts, then that forward contract should not generally be subject to Section 1256. The following is a list of cross-currency contracts in which positions are traded through regulated futures contracts as of the date of this Alert:

1. Australian dollar/Canadian dollar
2. Australian dollar/Japanese yen
3. Australian dollar/New Zealand dollar
4. British pound/Australian dollar

5. British pound/Canadian dollar
6. British pound/Japanese yen
7. British pound/New Zealand dollar
8. British pound/Norwegian krone
9. British pound/South African rand
10. British pound/Swedish krona
11. British pound/Swiss franc
12. Canadian dollar/Japanese yen
13. Chinese renminbi/Japanese yen
14. Euro/Australian dollar
15. Euro/British pound
16. Euro/Canadian dollar
17. Euro/Chinese renminbi
18. Euro/Czech koruna
19. Euro/Hungarian forint
20. Euro/Japanese yen
21. Euro/Norwegian krone
22. Euro/South African rand
23. Euro/Swedish krona
24. Euro/Swiss franc
25. New Zealand dollar/Japanese yen
26. Norwegian krone/Japanese yen
27. Norwegian krone/Swedish krona
28. Swedish krona/Japanese yen
29. Swiss franc/Japanese yen

The same arguments regarding thin trading referenced above with respect to foreign currency forward contracts would apply to cross-currency forward contracts as well.

Scope

This list is subject to change on an ongoing basis as new foreign currencies begin to trade in the regulated futures market and as

trading in other foreign currencies becomes thin or nonexistent. Please note that this list is updated annually and does not immediately reflect such changes in the status of foreign

currencies. Please contact the individuals listed before adopting a position with respect to whether Section 1256 applies to a particular currency.

Endnotes

1. See Notice 2007-71 in which the IRS states that it and the Treasury Department do not believe that foreign currency options are foreign currency contracts as defined in Section 1256(g)(2). Recent case law confirms that position.
2. Section 1256(b)(2).
3. Section 1256(f)(2).
4. Under Section 988(a)(1)(A), any foreign currency gain or loss is treated as ordinary income or loss. Under Section 988(b)(3), in the case of a forward contract on foreign currency, any gain or loss from that contract will be treated as foreign currency gain or loss. Section 988(a)(1)(B) does, however, provide for an election to treat any foreign currency gain or loss attributable to a forward contract on foreign currency as capital gain or loss rather than ordinary gain or loss.
5. A cross currency contract is a forward contract in which both legs of the contract are foreign (i.e., non-US dollar) currencies. For example, a forward contract in which the parties agree to exchange a fixed amount of euros for a fixed amount of British pounds is a cross-currency contract.

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