

To amend the Internal Revenue Code of 1986 with respect to the treatment of prepaid derivative contracts. (Introduced in House)

HR 4912 IH

110th CONGRESS

1st Session

H. R. 4912

To amend the Internal Revenue Code of 1986 with respect to the treatment of prepaid derivative contracts.

IN THE HOUSE OF REPRESENTATIVES

December 19, 2007

Mr. NEAL of Massachusetts introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 with respect to the treatment of prepaid derivative contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. TREATMENT OF PREPAID DERIVATIVE CONTRACTS.

(a) In General- Part V of subchapter P of chapter 1 of the Internal Revenue Code of 1986 (relating to special rules for bonds and other debt instruments) is amended by adding at the end the following new subpart:

`Subpart E--Prepaid Derivative Contracts

`Sec. 1289. Treatment of prepaid derivative contracts.

`Sec. 1289A. Definitions.

`SEC. 1289. TREATMENT OF PREPAID DERIVATIVE CONTRACTS.

`(a) Current Inclusion in Income- For purposes of this title, there shall be included in the gross income of the holder of a prepaid derivative contract an amount equal to the holder's interest accrual amount with respect to such contract for the taxable year. Any amount included in gross income under the preceding sentence shall be treated as interest.

`(b) Basis Adjustments- If any interest accrual amount is included in the gross income of the holder of a prepaid derivative contract under subsection (a), such holder's basis in such contract shall be increased by the amount so included.

`(c) Loss Treated as Ordinary to Extent of Basis Increases- In the case of any loss recognized on the disposi-

tion of any prepaid derivative contract, so much of such loss as does not exceed the aggregate increases in the basis of such contract under subsection (b) shall be treated as an ordinary loss.

`(d) Treatment of Distributions- In the case of any distribution under a prepaid derivative contract--

`(1) except as provided in paragraph (3), such distribution shall not be includible in gross income,

`(2) the adjusted basis of such contract shall be reduced (but not below zero) by the amount of such distribution, and

`(3) the excess (if any) of such distribution over such adjusted basis (determined before any reduction under paragraph (2)) shall be treated as gain from the sale of such contract.

For purposes of this subsection, adjusted basis shall be determined after any adjustment to such basis under subsection (b) for the taxable year.

`(e) Interest Accrual Amount-

`(1) IN GENERAL- For purposes of this section, the interest accrual amount with respect to any prepaid derivative contract for any taxable year is the product of--

`(A) the holder's adjusted basis in such contract as of the beginning of such taxable year, multiplied by

`(B) the greater of--

`(i) the monthly Federal short-term rate determined under section 1274(d) for the first month ending during such taxable year, or

`(ii) in the case of a contract under which notional amounts are credited, the rate at which such amounts are credited.

`(2) PRORATION OF INTEREST ACCRUAL AMOUNT- In the case of a taxpayer who acquires or disposes of any prepaid derivative contract during the taxable year, the interest accrual amount determined under paragraph (1) with respect to such contract for such year shall be an amount which bears the same ratio to--

`(A) the amount which would be so determined without regard to this subparagraph, as

`(B) the portion of such taxable year during which such contract was held by such taxpayer bears to the entire taxable year.

`(3) ADJUSTED BASIS DETERMINED AT ACQUISITION- In the case of the acquisition of any prepaid derivative contract during the taxable year, paragraph (1) shall be applied by substituting 'the acquisition of such contract' for 'the beginning of such taxable year'.

`(f) Special Rules for Publicly Traded Prepaid Derivative Contracts-

`(1) LIMITATION ON INCLUSION- The amount includible under subsection (a) with respect to the holder of any publicly traded prepaid derivative contract for any taxable year shall not exceed the excess (if any) of--

`(A) the sum of--

`(i) the fair market value of such contract as of the close of such taxable year (or, in the case of the disposition of such contract during the taxable year, as of such disposition), plus

`(ii) any distributions to the holder under such contract during such taxable year, over

`(B) the holder's adjusted basis in such contract as of the close of the preceding taxable year (or, in the case of the acquisition of the contract during the taxable year, as of such acquisition).

`(2) EXCESS CARRIED FORWARD- If the interest accrual amount with respect to any publicly traded prepaid derivative contract for any taxable year exceeds the limitation determined under paragraph (1) with respect to the holder of such contract for such year, the interest accrual amount of such holder with respect to such contract for the succeeding taxable year shall be increased by such excess.

`(3) INTEREST ACCRUAL AMOUNT IN SUCCEEDING YEARS UNAFFECTED BY LIMITATION- Solely for purposes of subsection (e)(1), the adjusted basis in a publicly traded prepaid derivative contract shall be determined without regard to paragraph (1).

`(g) Exception for Short Holding Periods and Instruments Marked to Market- This section shall not apply to any prepaid derivative contract for any taxable year if such contract--

`(1) has been held for less than 1 year and is disposed of in the taxable year in which acquired or on or before the due date for the return of income tax for such taxable year (without regard to any extension of time for filing such return), or

`(2) is marked to market with respect to the taxpayer for such taxable year under section 475 or 1256 or any other provision of this title.

`(h) Regulations- The Secretary shall issue such regulations as are necessary or appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section.

`SEC. 1290. DEFINITIONS.

`For purposes of this subpart--

`(1) PREPAID DERIVATIVE CONTRACT-

`(A) IN GENERAL- The term 'prepaid derivative contract' means any prepaid contract with a term of longer than 1 year from the date of issue which is a derivative financial instrument with respect to--

`(i) any security (as defined in section 475(c)(2), determined without regard to subparagraph (F) and the last sentence thereof) or group of securities (as so defined),

`(ii) any commodity (as defined in section 475(e)(2), determined without regard to subparagraph (D) thereof) or group of commodities (as so defined), or

`(iii) any financial index.

`(B) EXCEPTIONS- Such term shall not include any instrument which is treated (for purposes of this title) as--

- `(i) stock or debt,
- `(ii) an interest in a partnership,
- `(iii) part of a constructive ownership transaction to which section 1260 applies,
- `(iv) a hedging transaction (as defined in section 1256(e)(2)),
- `(v) a notional principal contract, or
- `(vi) an option.

`(C) CERTAIN OPTIONS ECONOMICALLY SIMILAR TO OWNERSHIP- To the extent provided by the Secretary in regulations or other guidance, any option which by reason of such option's term and strike price is economically similar to a prepaid contract described in subparagraph (A) shall not be treated as an option for purposes of subparagraph (B)(vi).

`(2) PREPAID CONTRACT- The term `prepaid contract' means any contract under which there is no substantial likelihood that the taxpayer will be required to pay any additional amount under the contract. For purposes of the preceding sentence, a taxpayer shall not be treated as having a substantial likelihood of being required to pay any additional amount if those additional amounts have been set aside (or are expected to be set aside) with respect to such payment or are subject to a defeasance arrangement or other arrangement similar to an arrangement described in section 470(d)(1)(B).

`(3) PUBLICLY TRADED PREPAID DERIVATIVE CONTRACT- The term `publicly traded prepaid derivative contract' means any prepaid derivative contract--

`(A) which is traded on or subject to the rules of a qualified board or exchange, or

`(B) with respect to which the issuer (or any person acting on behalf of the issuer) regularly makes available to the public (including customers or subscribers) bid or offer quotes and stands ready to effect buy or sell transactions at the quoted prices for itself or on behalf of others.'.

(b) Conforming Amendments-

(1) The table of subparts for part V of subchapter P of chapter 1 of such Code is amended by adding at the end the following new item:

`subpart e--prepaid derivative contracts.'.

(2) The heading of part V of subchapter P of chapter 1 of such Code, and the item relating to such part in the table of parts for subchapter P of chapter 1 of such Code, are each amended by striking `debt'.

(c) Effective Date- The amendments made by this section shall apply to contracts acquired after the date of the enactment of this Act.