

Internal Revenue Code Section 475

Mark to market accounting method for dealers in securities

(a) General rule.

Notwithstanding any other provision of this subpart, the following rules shall apply to securities held by a dealer in securities:

- (1) Any security which is inventory in the hands of the dealer shall be included in inventory at its fair market value.
- (2) In the case of any security which is not inventory in the hands of the dealer and which is held at the close of any taxable year-
 - (A) the dealer shall recognize gain or loss as if such security were sold for its fair market value on the last business day of such taxable year, and
 - (B) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence. The Secretary may provide by regulations for the application of this paragraph at times other than the times provided in this paragraph .

(b) Exceptions.

(1) In general.

Subsection (a) shall not apply to-

- (A) any security held for investment,
- (B) (i) any security described in subsection (c)(2)(C) which is acquired (including originated) by the taxpayer in the ordinary course of a trade or business of the taxpayer and which is not held for sale, and (ii) any obligation to acquire a security described in clause (i) if such obligation is entered into in the ordinary course of such trade or business and is not held for sale, and
- (C) any security which is a hedge with respect to-
 - (i) a security to which subsection (a) does not apply, or
 - (ii) a position, right to income, or a liability which is not a security in the hands of the taxpayer.

To the extent provided in regulations, subparagraph (C) shall not apply to any security held by a person in its capacity as a dealer in securities.

(2) Identification required.

A security shall not be treated as described in subparagraph (A) , (B) , or (C) of paragraph (1) , as the case may be, unless such security is clearly identified in the dealer's records as being described in such subparagraph before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe).

(3) Securities subsequently not exempt.

If a security ceases to be described in paragraph (1) at any time after it was identified as such under paragraph (2) , subsection (a) shall apply to any changes in value of the security occurring after the cessation.

(4) Special rule for property held for investment.

To the extent provided in regulations, subparagraph (A) of paragraph (1) shall not apply to any security described in subparagraph (D) or (E) of subsection (c)(2) which is held by a dealer in such securities.

(c) Definitions.

For purposes of this section -

(1) Dealer in securities defined.

The term "dealer in securities" means a taxpayer who-

- (A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or
- (B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

(2) Security defined.

The term "security" means any-

- (A) share of stock in a corporation;
- (B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;
- (C) note, bond, debenture, or other evidence of indebtedness;
- (D) interest rate, currency, or equity notional principal contract;
- (E) evidence of an interest in, or a derivative financial instrument in, any security described in subparagraph (A) , (B) , (C) , or (D) , or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency; and
- (F) position which-
 - (i) is not a security described in subparagraph (A) , (B) , (C) , (D) , or (E)

(ii) is a hedge with respect to such a security, and

(iii) is clearly identified in the dealer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

Subparagraph (E) shall not include any contract to which section 1256(a) applies.

(3) Hedge.

The term "hedge" means any position which manages the dealer's risk of interest rate or price changes or currency fluctuations, including any position which is reasonably expected to become a hedge within 60 days after the acquisition of the position.

(4) Special rules for certain receivables.

(A) In general. Paragraph (2)(C) shall not include any nonfinancial customer paper.

(B) Nonfinancial customer paper. For purposes of subparagraph (A) , the term "nonfinancial customer paper" means any receivable which-

(i) is a note, bond, debenture, or other evidence of indebtedness;

(ii) arises out of the sale of nonfinancial goods or services by a person the principal activity of which is the selling or providing of nonfinancial goods or services; and

(iii) is held by such person (or a person who bears a relationship to such person described in section 267(b) or 707(b)) at all times since issue.

(d) Special rules.

For purposes of this section -

(1) Coordination with certain rules.

The rules of sections 263(g) , 263A , and 1256(a) shall not apply to securities to which subsection (a) applies, and section 1091 shall not apply (and section 1092 shall apply) to any loss recognized under subsection (a) .

(2) Improper identification.

If a taxpayer-

(A) identifies any security under subsection (b)(2) as being described in subsection (b)(1) and such security is not so described, or

(B) fails under subsection (c)(2)(F)(iii) to identify any position which is described in subsection (c)(2)(F) (without regard to clause (iii) thereof) at the time such identification is required,

the provisions of subsection (a) shall apply to such security or position, except that any loss under this section prior to the disposition of the security or position shall be recognized only to the extent of gain previously recognized under this section (and not

previously taken into account under this paragraph) with respect to such security or position.

(3) Character of gain or loss.

(A) In general. Except as provided in subparagraph (B) or section 1236(b) -

(i) In general. Any gain or loss with respect to a security under subsection (a)(2) shall be treated as ordinary income or loss.

(ii) Special rule for dispositions. If-

(I) gain or loss is recognized with respect to a security before the close of the taxable year, and

(II) subsection (a)(2) would have applied if the security were held as of the close of the taxable year,

such gain or loss shall be treated as ordinary income or loss.

(B) Exception. Subparagraph (A) shall not apply to any gain or loss which is allocable to a period during which-

(i) the security is described in subsection (b)(1)(C) (without regard to subsection (b)(2)),

(ii) the security is held by a person other than in connection with its activities as a dealer in securities, or

(iii) the security is improperly identified (within the meaning of subparagraph (A) or (B) of paragraph (2)).

(e) Election of mark to market for dealers in commodities.

(1) In general.

In the case of a dealer in commodities who elects the application of this subsection , this section shall apply to commodities held by such dealer in the same manner as this section applies to securities held by a dealer in securities.

(2) Commodity.

For purposes of this subsection and subsection (f) , the term "commodity" means-

(A) any commodity which is actively traded (within the meaning of section 1092(d)(1));

(B) any notional principal contract with respect to any commodity described in subparagraph (A) ;

(C) any evidence of an interest in, or a derivative instrument in, any commodity described in subparagraph (A) or (B) , including any option, forward contract, futures contract, short position, and any similar instrument in such a commodity; and

(D) any position which-

(i) is not a commodity described in subparagraph (A) , (B) , or (C) ,

(ii) is a hedge with respect to such a commodity, and

(iii) is clearly identified in the taxpayer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

(3) Election.

An election under this subsection may be made without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(f) Election of mark to market for traders in securities or commodities.

(1) Traders in securities.

(A) In general. In the case of a person who is engaged in a trade or business as a trader in securities and who elects to have this paragraph apply to such trade or business-

(i) such person shall recognize gain or loss on any security held in connection with such trade or business at the close of any taxable year as if such security were sold for its fair market value on the last business day of such taxable year, and

(ii) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence. The Secretary may provide by regulations for the application of this subparagraph at times other than the times provided in this subparagraph .

(B) Exception. Subparagraph (A) shall not apply to any security-

(i) which is established to the satisfaction of the Secretary as having no connection to the activities of such person as a trader, and

(ii) which is clearly identified in such person's records as being described in clause (i) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe).

If a security ceases to be described in clause (i) at any time after it was identified as such under clause (ii) , subparagraph (A) shall apply to any changes in value of the security occurring after the cessation.

(C) Coordination with section 1259 . Any security to which subparagraph (A) applies and which was acquired in the normal course of the taxpayer's activities as a trader in securities shall not be taken into account in applying section 1259 to any position to which subparagraph (A) does not apply.

(D) Other rules to apply. Rules similar to the rules of subsections (b)(4) and (d) shall apply to securities held by a person in any trade or business with respect to which an election under this paragraph is in effect. Subsection (d)(3) shall not apply under the preceding sentence for purposes of applying sections 1402 and 7704 .

(2) Traders in commodities.

In the case of a person who is engaged in a trade or business as a trader in commodities and who elects to have this paragraph apply to such trade or business, paragraph (1) shall apply to commodities held by such trader in connection with such trade or business in the same manner as paragraph (1) applies to securities held by a trader in securities.

(3) Election.

The elections under paragraphs (1) and (2) may be made separately for each trade or business and without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(g) Regulatory authority.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section , including rules-

(1) to prevent the use of year-end transfers, related parties, or other arrangements to avoid the provisions of this section ,

(2) to provide for the application of this section to any security which is a hedge which cannot be identified with a specific security, position, right to income, or liability, and

(3) to prevent the use by taxpayers of subsection (c)(4) to avoid the application of this section to a receivable that is inventory in the hands of the taxpayer (or a person who bears a relationship to the taxpayer described in section 267(b) or 707(b)).