Contract, the loss on Futures Contract is disallowed in Year 3 under paragraph (c) of this section. Further, under paragraph (c) of this section and section 1092(a)(1), on December 31, Year 3, the disallowed loss of $2 on Futures Contract cannot be recognized because it is less than the total unrecognized gain of $6 on Note on December 31, Year 3.

(iii) *Year 10 analysis*. When Note matures in Year 10, the $5 of unrecognized long-term capital gain that arose prior to the identified mixed straddle is recognized. Because A receives $100 upon the maturity of Note, A also recognizes a $5 long-term capital loss on Note, for a net gain of $0 (zero). In addition, the termination of all positions in the identified mixed straddle releases the $2 loss disallowed in Year 3 on Futures Contract. The loss on Futures Contract is treated as short-term capital loss in Year 10 under §1.1092(b)–3T(b)(4).

(e) *Effective/applicability date*. The rules of this section apply to all section 1092(b)(2) identified mixed straddles established after August 18, 2014.

[T.D. 9678, 79 FR 41888, July 18, 2014]

§ 1.1092(c)–1 Qualified covered calls.

(a) *In general*. Section 1092(c) defines a straddle as offsetting positions with respect to personal property. Under section 1092(d)(3)(B)(i)(I), stock is personal property if the stock is part of a straddle that involves an option on that stock or substantially identical stock or securities. Under section 1092(c)(4), however, writing a qualified covered call option and owning the optioned stock is not treated as a straddle under section 1092 if certain conditions, described in section 1092(c)(4)(B), are satisfied. Section 1092(c)(4)(H) authorizes the Secretary to modify these conditions to carry out the purposes of section 1092(c)(4) in light of changes in the marketplace.

(b) *Term limitation*—(1) *General rule*. Except as provided in paragraph (b)(2) of this section, an option is not a qualified covered call unless it is granted not more than 12 months before the day on which the option expires or satisfies term limitation and qualified benchmark requirements established by the Commissioner in guidance published in the Internal Revenue Bulletin (*see* §601.601(d)(2)(ii)(*b*) of this chapter).

(2) *Special benchmark rule for an option granted not more than 33 months before the day on which the option expires*—(i) *In general*. The 12-month limitation described in paragraph (b)(1) of this section is extended to 33 months provided the lowest qualified benchmark is determined using the adjusted applicable stock price, as defined in §1.1092(c)–4(e).

(ii) *Examples*. The following examples illustrate the rules set out in paragraph (b)(2)(i) of this section:

Example 1. Taxpayer owns stock in Corporation X. Taxpayer writes an equity option with standardized terms on Corporation X stock through a national securities exchange with a term of 21 months. The applicable stock price for Corporation X stock is $100. The bench marks for a 21-month equity option with standardized terms with an applicable stock price of $100 will be based upon the adjusted applicable stock price. Using the table at §1.1092(c)–4(e), the applicable stock price of $100 is multiplied by the adjustment factor 1.12, resulting in an adjusted applicable stock price of $112. Using the bench marks for an equity option with standardized terms with an adjusted applicable stock price of $112, the highest available strike price less than the adjusted applicable stock price is $110, and the second highest strike price less than the adjusted applicable stock price is $105. Therefore, a 21-month equity call option with standardized terms on Corporation X stock will not be deep in the money if the strike price is not less than $105.

Example 2. Taxpayer owns stock in Corporation Y. Taxpayer writes an equity option with standardized terms on Corporation Y stock through a national securities exchange with a term of 21 months. The applicable stock price for Corporation Y stock is $13.25. The bench marks for a 21-month equity option with standardized terms with an applicable stock price of $13.25 will be based upon the adjusted applicable stock price. Using the table at §1.1092(c)–4(e), the applicable stock price of $13.25 is multiplied by the adjustment factor 1.12, resulting in an adjusted applicable stock price of $14.84. Using the bench marks for an equity option with standardized terms with an adjusted applicable stock price of $14.84, the highest available strike price less than the adjusted applicable stock price is $12.50. However, under section 1092(c)(4)(D), the lowest qualified bench mark can be no lower than 85% of the applicable stock price, which for Corporation Y stock is $12.61 (85% of the adjusted applicable stock price of $14.84). Thus, because the highest available strike price less than the adjusted applicable stock price for an equity option with standardized terms is lower than the lowest qualified bench mark under section 1092(c)(4)(D), the lowest strike price at which a qualified covered call option can be written is the next higher strike price, or

$15.00. Therefore, a 21-month equity call option with standardized terms on Corporation Y stock will not be deep in the money if the strike price is not less than $15.

(c) *Effective date.* This section applies to qualified covered call options entered into on or after July 29, 2002.

[67 FR 20899, Apr. 29, 2002]

§ 1.1092(c)–2 Equity options with flexible terms.

(a) *In general.* Section 1092(c)(4) provides an exception to the general rule that a straddle exists if a taxpayer holds stock and writes a call option on that stock. Under section 1092(c)(4), the ownership of stock and the issuance of a call option meeting certain requirements result in a qualified covered call, which is exempted from the general straddle rules of section 1092. This section addresses the consequences of the availability of equity options with flexible terms under the qualified covered call rules.

(b) *No effect on lowest qualified bench mark for standardized options.* The availability of strike prices for equity options with flexible terms does not affect the determination of the lowest qualified bench mark, as defined in section 1092(c)(4)(D), for an equity option with standardized terms.

(c) *Qualified covered call option status*—(1) *Requirements.* An equity option with flexible terms is a qualified covered call option only if—

(i) The option meets the requirements of section 1092(c)(4)(B) and § 1.1092(c)–1 (taking into account paragraph (c)(2) of this section);

(ii) The only payments permitted with respect to the option are a single fixed premium paid not later than 5 business days after the day on which the option is granted, and a single fixed strike price, as defined in § 1.1092(c)–4(d), that is payable entirely at (or within 5 business days of) exercise;

(iii) An equity option with standardized terms is outstanding for the underlying equity; and

(iv) The underlying security is stock in a single corporation.

(2) *Lowest qualified bench mark*—(i) *In general.* For purposes of determining whether an equity option with flexible terms is deep in the money within the meaning of section 1092(c)(4)(C), the lowest qualified bench mark under section 1092(c)(4)(D) is the same for an equity option with flexible terms as the lowest qualified bench mark for an equity option with standardized terms on the same stock having the same applicable stock price.

(ii) *Examples.* The following examples illustrate the rules set out in paragraph (c)(2)(i) of this section:

Example 1. Taxpayer owns stock in Corporation X. Taxpayer writes an equity call option with flexible terms on Corporation X stock through a national securities exchange for a term of not more than 12 months. The applicable stock price for Corporation X stock is $73.75. Using the bench marks for an equity option with standardized terms with an applicable stock price of $73.75, the highest available strike price less than the applicable stock price is $70, and the second highest strike price less than the applicable stock price is $65. Therefore, an equity call option with flexible terms on Corporation X stock with a term of 90 days or less will not be deep in the money if the strike price is not less than $70. If the term is greater than 90 days, an equity call option with flexible terms on Corporation X will not be deep in the money if the strike price is not less than $65.

Example 2. Taxpayer owns stock in Corporation Y. Taxpayer writes a 9-month equity call option with flexible terms on Corporation Y stock through a national securities exchange. The applicable stock price for Corporation Y stock is $14.75. Using the bench marks for an equity option with standardized terms with an applicable stock price of $14.75, the highest available strike price less than the applicable stock price is $12.50. However, under section 1092(c)(4)(D), the lowest qualified bench mark can be no lower than 85% of the applicable stock price, which for Corporation Y stock is $12.54. Thus, because the highest available strike price less than the applicable stock price for an equity option with standardized terms is lower than the lowest qualified bench mark under section 1092(c)(4)(D), the lowest strike price at which a qualified covered call option can be written is the next higher strike price, or $15.00. This $15.00 strike price requirement for a qualified covered call option applies to equity options with flexible terms, equity options with standardized terms, and qualifying over-the-counter options.

Example 3. Taxpayer owns stock in Corporation Z. On May 8, 2003, Taxpayer writes a 21-month equity call option with flexible terms on Corporation Z stock through a national securities exchange. The applicable stock price for Corporation Z stock is $100.