**HEADLINE:** 98 Tax Notes 649 - NEWS ANALYSIS: NO CONSTRUCTIVE SALE IN A DECS TRANSACTION. (Section 1259 -- Appreciated Financial Positions) (Release Date: JANUARY 29, 2003)

Release Date: JANUARY 29, 2003 [\*649]

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There's a time machine on Long Island.

The item in question is the $ 600 million Relativistic Heavy Ion Collider, located at the Brookhaven National Laboratory on Long Island. The ion collider, an atom smasher that is so big that it is visible from outer space, is supposed to replicate the Big Bang that physicists and astronomers believe occurred at the creation of the universe 14 billion years ago. The ion collider is the first machine to use head-on collisions of atoms to replicate the Big Bang in miniature. In so doing, the ion collider creates matter that is more dense and opaque than theorists predicted. (The New York Times, Jan. 14, 2003, p. F1.)

The IRS might need to borrow this time machine to administer the equally dense and opaque ruling that no common-law constructive sale took place on the pledge of shares to satisfy a publicly traded forward contract. The original state of the universe is easier to understand than this ruling, [Rev. Rul. 2003-7, 2003-5 IRB 1.](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=2&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=b15c8321707ac9621dc68b0152baf3e0) (For the ruling, see [2003 TNT 12-13](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=3&_butInline=1&_butinfo=2003%20TNT%2012-13&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=d05f7294f3198ec0a54dcc768b0b7fe4).)

The ruling basically stands to set back any effort the government might make to determine the larger question of when the taxpayer's economic ownership is insufficient for the taxpayer's tax ownership to be respected. Were the president's dividend exclusion proposal to be enacted, there would be a great deal of pressure on the concept of economic ownership.

So at the January 24 meeting of the American Bar Association Section of Taxation Financial Transactions Committee in San Antonio, light years away from Brookhaven, practitioners were understandably curious about how far they could go with the government's recent ruling. They queried Matthew Stevens, special counsel to the IRS chief counsel, and Viva Hammer, an attorney-adviser in Treasury's office of tax policy, on constructive sale questions.

Stevens had previously indicated on several occasions that the IRS National Office wanted to cut off agents' constructive sale arguments. Readers understand that even the simplest revenue ruling requires a consensus from a roomful of government lawyers, and [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=4&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=7950f7a57e0a3622a9048d8efac5b400) was no different in this regard. The free-ranging discussion allowed the losers in bureaucratic infighting over the ruling to voice their own views about what the law should be.

Constructive Sale Ruling

In [Rev. Rul. 2003-7,](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=5&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=41dbd35b42fe5d5165a94331dfca8313) the IRS ruled that the receipt of cash on a pledge of shares did not constitute a constructive sale of those shares if the taxpayer who pledged them retained the right to substitute collateral and is not economically compelled to deliver the pledged shares in a STRYPES contract (the retail version of a DECS).

This ruling effectively quashes the argument made by some IRS agents in Denver that a common-law constructive sale took place in a STRYPES transaction, and ratifies legislative history stating that [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=6&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=ef4693f9cfb88a6ab69c5ae7d562e855) does not apply to these arrangements. (For discussion, see [2002 TNT 191-4](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=7&_butInline=1&_butinfo=2002%20TNT%20191-4&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=f188b3a545c068c62093a6f6ff35d903).)

DECS are investment units consisting of: a prepaid forward contract to purchase some portfolio holding of the issuer; plus an interest-bearing deposit that the holder makes with the issuer as collateral for the forward contract. DECS purport to be short-term to medium-term notes, bearing stated interest, issued for the market price of a single common share of the portfolio holding that the issuer (which may be an investment bank acting on behalf of the individual owner) wants to monetize.

The ruling concerns a three-year variable delivery forward contract for publicly traded shares held by an individual that resembles a STRYPES transaction. The counterparty to the contract was an investment bank. The taxpayer pledged the maximum number of shares that would be deliverable under the contract as collateral for the obligation to perform on the contract. The pledged shares were held by a third-party trustee. The taxpayer retained the right to vote the shares and collect dividends. The taxpayer was protected from downside risk of holding the shares during the term of the contract by the variable delivery formula, which collared a 25 percent range of prices.

The taxpayer received cash in an unstated amount. (In the usual case, the amount is the discounted present value of the maximum number of shares deliverable under the contract.) The taxpayer had the unrestricted legal right to satisfy the contractual delivery obligation by delivering [\*650]  the pledged shares, or substitute shares of the same issuer, or cash. The ruling posits that the taxpayer "is not otherwise economically compelled to deliver the pledged shares." At the time the contract was made, however, the taxpayer intended to deliver the pledged shares.

For its ruling, the IRS relied on case law that states that a pledge of shares for a margin loan is not a sale. Under the case law, the fact that a brokerage firm held legal title to publicly traded shares in a subordination account and had the right to sell them to satisfy its creditors did not preclude the firm's customer from having tax ownership of the shares. The customer retained the right to vote the shares, collect dividends, and substitute collateral in the subordination account. In [Miami National Bank v. Commissioner, 67 T.C. 793 (1977),](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=8&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b67%20T.C.%20793%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=312c106b1ccbc6690fee3c90f70fc0aa) the Tax Court held that the creation of the subordination account did not cause the brokerage firm to become the owner of the shares, noting that the customer did substitute collateral when the firm went bust.

Thus the IRS concluded in [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=9&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=70d16fe437970245e3fcb7eb7f2d27b9) that "transfer of actual possession of stock or securities and legal title may not itself be sufficient to constitute a transfer of beneficial ownership when the transferor retains the unrestricted right and ability to reacquire the securities." The IRS relied heavily on the proposition that the taxpayer had the unrestricted right to reacquire the pledged shares by substituting cash or other shares, and that the taxpayer was not economically compelled to deliver the pledged shares, for its ruling that no constructive sale had occurred under common law.

"A different outcome may be warranted if a shareholder is under any legal restraint or requirement or under any economic compulsion to deliver pledged shares rather than to exercise a right to deliver cash or other shares," [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=10&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=b2b5027d02f73e76662b93a1059b2c0c) states. The ruling elaborates that economic compulsion might exist if the taxpayer was broke or not permitted to hold the pledged shares after the maturity date of the contract.

The ruling further states that no constructive sale occurred under [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=11&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=24e6f79c7204db0d0493404b29aecc1e) because the variable delivery formula posited in the facts would result in "significant variation" in the number of shares deliverable under the contract, within the contemplation of the legislative history. The taxwriting committees' reports on [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=12&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=e0d3d1965757ad2ead002a186e7f5865) both state that a forward contract that provides for "significant" variation in the amount of property to be delivered does not result in a constructive sale. The ruling carefully noted that the significant variation only withdrew the contract from the forward contract definition of [section 1259(c)(1)(C)](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=13&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=9e5e47fa6294ad139ef40cb64832dab3). This leaves open questions under [sections 1259(d)(1)](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=14&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=1e2e49b562f87886a1d68b26e20aa825) and (c)(1)(E).

Economic Compulsion

It is important to the ruling that the IRS posited that the taxpayer was not economically compelled to deliver the shares at the time the contract was made. Practitioners argued for testing for economic compulsion on the date the contract was made, and the ruling is based on the idea that testing is done on the date the contract is made.

Stevens mused about scenarios that the ruling plainly does not contemplate. He said that he personally would prefer that the test focus on the taxpayer's economic situation on the future delivery date, but he recognized that this would be impractical. The taxpayer's temporary inability to substitute collateral on the date the contract is made would be irrelevant in this view. Just to make it fun, he added that unforeseen intervening events could conceivably determine the taxpayer's economic compulsion to deliver shares by destroying a previous expectation that other collateral would be substituted. Intervening events might include a short squeeze in the pledged shares or the bankruptcy of the individual taxpayer.

The implication of Stevens's comment about intervening events, as Hammer and several practitioners participating in the discussion observed, would be that continual testing of the taxpayer's economic circumstances would be required over the term of the forward sale contract. Hammer added that the intervening event could also be reversed during the period of the contract. She questioned whether continual testing would be administrable by the IRS. The IRS won't know about a temporary short squeeze, she noted. Stevens noted that intervening events would be rare, and the IRS would have a heavy burden proving that economic compulsion existed.

What is economic compulsion in this context? Stevens theorized that an intervening event affecting another block of the shares of the same issuer retained by the taxpayer, other than the pledged shares, could cause a constructive sale of the pledged shares. For example, another [\*651]  creditor of the taxpayer's might claim that retained block of shares in the intervening period, destroying the taxpayer's ability to substitute them for the pledged shares. This would cause a constructive sale of the pledged shares if the taxpayer had no cash settlement (most have a cash settlement option). Practitioners were baffled and found this inconsistent with the realization requirement.

That is, the call option initially represented by the STRYPES contract could be transmuted into a forward sale. After all, Stevens noted, the taxpayer got all the cash up front, and legally parted with the shares by putting them in escrow. Thus the taxpayer already will have parted with sufficient indicia of ownership and control that an additional intervening event could conceivably tip the deal over into a constructive sale.

Stevens emphasized that there would not be a hair-trigger test. Practitioners reiterated their previous requests for a safe harbor collar that would preclude constructive sale treatment, and wanted to believe that the stated range of variable prices in the ruling is an acceptable safe harbor collar for purposes of [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=15&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=2dca3dc427902bfd33c1382e118deeea). The stated facts in the ruling, however, do not have any implication for future [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=16&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=2e419c1d37deb1ee496666f40f63a06d) safe harbor collar guidance, Hammer had noted in discussions earlier in the day. Stevens agreed.

How many shares would have been constructively sold? The pledged shares -- that is, the maximum number of shares deliverable under the contract -- Stevens said, noting that there would have to be an adjustment if fewer shares were delivered. Does [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=17&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=08536c0b1a90f83b2211aa272aaf9efc) apply to forward sales of shares that are not publicly traded? Yes, Hammer and Stevens noted, as long as the taxpayer has a cash settlement option.

Fungible Shares

By relying on old case law that hinges on the identification of shares, [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=18&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=505901b453464909d9349bfa475bd35f) gives undue credence to the share identification fiction in the face of the reality of fungible shares traded in public securities markets. Of course, when the government writes a revenue ruling, it looks a lot better -- particularly with cranky critics like your correspondent loose in the world -- to cite authority. Nonetheless, reliance on outmoded authority carries the risk of giving it undue credibility so that taxpayers doing things the government would not like could rely on it. There was this worry inside the government.

What if the shares that were the subject of the STRYPES were publicly traded and readily available, so that the taxpayer could easily substitute new shares? Stevens believed that the fact that the taxpayer would have to pay relatively small brokerage commissions to get new shares would not constitute economic compulsion. But if the taxpayer had committed to the SEC to deliver the pledged shares and no other, there would be compulsion to deliver, he noted. The ruling depends on the taxpayer's ability to get the pledged shares back, Stevens emphasized.

What if the taxpayer had two blocks of shares, and had pledged the block with the higher basis? Would the prospect of a larger capital gain on the substitution of the lower-basis block constitute economic compulsion? Stevens could not answer that question because it was heavily fact-dependent.

Stevens and the practitioners went back and forth on the significance of the holding of shares in street name or under a custodial agreement. Does [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=19&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=1f2df033dcbb71a52adeabe6d46eb774) require a third-party custodian for the shares to preclude a constructive sale? Practitioners noted that there is a range of types of pledge agreements, most of which involve transfer of legal title, but that the presence of a third-party custodian might prevent the investment bank that is the counterparty to the forward contract from having a security interest in the shares. Stevens said that he contemplated a pledge agreement in which the taxpayer had the vote and dividends passed through.

Practitioners explained that the usual STRYPES-type agreement has the investment bank counterparty holding the shares and not allowed to do anything with them, like disposing of them or using them for short sales. Stevens responded that these restrictions on the counterparty's ability to dispose of the shares would preclude a constructive sale. But if the investment bank has the right to use the pledged shares for short sales and other investment banking needs, as long as it substitutes other shares, then Stevens would find a constructive sale. All of this is despite the fact that the investment bank will end up with the pledged shares in the end, Stevens admitted.

Should it matter that pledged publicly traded shares might be fungible with zillions of other identical shares that the investment bank that is the counterparty might be holding in inventory? Not while the law still permits the taxpayer to identify shares.

Here, both the ruling and the practitioners fell back on decades of short sale case law supporting [\*652]  identification in the face of fungibility. This ancient case law holds short sales open until the identified shares that are the subject of the short sale are delivered to cover it. Stevens noted that the historical practices of physical share certificates and direct ownership meant that this formalistic case law might no longer be relevant to the modern world of fungible shares that exist only as book entries in street name.

Practitioners argued for exclusive jurisdiction for constructive sales under [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=20&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=967819abb60a71ba4de15a2b055c679c). Does the IRS have authority under [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=21&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=5c9ff1842c37083524ec4b0dd0c34d9f) to "turn off" all of the common law authority? Hammer responded that [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=22&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=32c568d2b06613648aba994d31bc3304) does not cover the waterfront, so the government has to have answers for the gaps. [Rev. Rul. 2003-7](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=23&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5bRev.%20Rul.%202003-7%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=42c5d4e0253f059d021ed4c5b4abe6e0) is a ruling about the common law, not about [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=24&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=72b6678e951a147b0e89dc69f3ded124), she emphasized. The ruling does not address the important questions of volatility of the share price or length of the contract. Hammer emphasized that the ruling should not be read as having implications for future [section 1259](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=25&_butInline=1&_butinfo=IRCODE%201259&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=da550a084c2b5dceed9b995a3fb137b7) regulations.

The ruling also has nothing to say about that other important DECS question, the application of [section 263(g)](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=26&_butInline=1&_butinfo=IRCODE%20263&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=634f7f086233f767dcc8b5a41afa2610) to require capitalization of the carrying costs of a straddle. Finalization of proposed [section 263(g)](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=27&_butInline=1&_butinfo=IRCODE%20263&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=cae84e4267d4182a5a5a8fb56497c4fc) regulations is on the IRS business plan, but other financial projects may have priority over it. The [section 263(g)](https://www.lexis.com/research/buttonTFLink?_m=200d3b5911c1f9b5148dd37b396b8f0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b98%20Tax%20Notes%20649%5d%5d%3e%3c%2fcite%3e&_butType=4&_butStat=0&_butNum=28&_butInline=1&_butinfo=IRCODE%20263&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzV-zSkAz&_md5=1720faebdacc673c421956759b19ec21) regulations are at the bottom of the financial pile.