

(b) *Effective date*—(1) *In general.* This section applies to positions established on or after March 17, 1995.

(2) *Special rule for certain straddles.* This section applies to positions established after March 1, 1984, if the taxpayer substantially diminished its risk of loss by holding substantially similar or related property involving the following types of transactions—

(i) Holding offsetting positions consisting of stock and a convertible debenture of the same corporation where the price movements of the two positions are related; or

(ii) Holding a short position in a stock index regulated futures contract (or alternatively an option on such a regulated futures contract or an option on the stock index) and stock in an investment company whose principal holdings mimic the performance of the stocks included in the stock index (or alternatively a portfolio of stocks whose performance mimics the performance of the stocks included in the stock index).

[T.D. 8590, 60 FR 14641, Mar. 20, 1995]

#### CAPITAL GAINS AND LOSSES

##### Treatment of Capital Gains

#### § 1.1201-1 Alternative tax.

(a) *Corporations*—(1) *In general.* (i) If for any taxable year a corporation has net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977) (as defined in section 1222(11)) section 1201(a) imposes an alternative tax in lieu of the tax imposed by sections 11 and 511, but only if such alternative tax is less than the tax imposed by sections 11 and 511. The alternative tax is not in lieu of the personal holding company tax imposed by section 541 or of any other tax not specifically set forth in section 1201(a).

(ii) In the case of an insurance company, the alternative tax imposed by section 1201(a) is also in lieu of the tax imposed by sections 821 (a) or (c) and 831 (a), except that for taxable years beginning before January 1, 1963, the reference to section 821 (a) or (c) is to be read as reference to section 821 (a)(1) or (b). For taxable years beginning after December 31, 1954, and before January 1, 1958, the alternative tax im-

posed by section 1201(a) shall also be in lieu of the tax imposed by section 802(a), as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 38), if such alternative tax is less than the tax imposed by such section. See section 802(e), as added by the Life Insurance Company Tax Act for 1955 (70 Stat. 39). However, for taxable years beginning after December 31, 1958, and before January 1, 1962, section 802(a)(2), as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 115), imposes a separate tax equal to 25 percent of the amount by which the net long-term capital gain of any life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3) exceeds its net short-term capital loss. See paragraph (f) of § 1.802-3. For alternative tax for life insurance companies in the case of taxable years beginning after December 31, 1961, see section 802(a)(2) and the regulations thereunder.

(iii) See section 56 and the regulations thereunder for provisions relating to the minimum tax for tax preferences.

(2) *Alternative tax.* The alternative tax is the sum of:

(i) A partial tax computed at the rates provided in sections 11, 511, 821 (a) or (c), and 831(a), on the taxable income of the taxpayer reduced by the amount of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977), and

(ii) An amount equal to the tax determined under subparagraph (3) of this paragraph.

For taxable years beginning after December 31, 1954, and before January 1, 1958, the partial tax under subdivision (i) of this subparagraph shall also be computed at the rates provided in section 802(a). For taxable years beginning before January 1, 1963, the reference in such subdivision to section 821 (a) or (c) is to be read as a reference to section 821 (a) or (b).

(3) *Tax on capital gains.* For purposes of subparagraph (2)(ii) of this paragraph, the tax shall be:

(i) In the case of a taxable year beginning after December 31, 1974, a tax of 30 percent of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976),

(ii) In the case of a taxable year beginning after December 31, 1969, and before January 1, 1975:

(a) A tax of 25 percent of the lesser of the amount of the subsection (d) gain (as defined in section 1201(d) and paragraph (f) of this section) or the amount of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976), plus

(b) A tax of 30 percent (28 percent in the case of a taxable year beginning after December 31, 1969, and before January 1, 1971) of the excess, if any, of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) over the subsection (d) gain,

(iii) In the case of a taxable year beginning before January 1, 1970, and after March 31, 1954, a tax of 25 percent of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976), or

(iv) In the case of a taxable year beginning before April 1, 1954, a tax of 26 percent of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976).

(4) *Determination of special deductions.* In the computation of the partial tax described in subparagraph (2)(i) of this paragraph the special deductions provided for in sections 243, 244, 245, 247, 922, and 941 shall not be recomputed as the result of the reduction of taxable income by the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977).

(b) *Other taxpayers*—(1) *In general.* If for any taxable year a taxpayer (other than a corporation) has net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977) (as defined in section 1222(11)) section 1201(b) imposes an alternative tax in lieu of the tax imposed by sections 1 and 511, but only if such alternative tax is less than the tax imposed by sections 1 and 511. The alternative tax is not in lieu of any other tax not specifically set forth in section 1201(b). See section 56 and the regulations thereunder for provisions relating to the minimum tax for tax preferences.

(2) *Alternative tax.* The alternative tax is the sum of:

(i) A partial tax computed at the rates provided by sections 1 and 511 on

the taxable income reduced by an amount equal to 50 percent of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977), and

(ii) In the case of a taxable year beginning after December 31, 1969:

(a) A tax of 25 percent of the lesser of the amount of the subsection (d) gain (as defined in section 1201(d) and paragraph (f) of this section) or the amount of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977), plus

(b) A tax computed as provided in section 1201(c) and paragraph (e) of this section on the excess, if any, of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977) over the subsection (d) gain, or

(iii) In the case of a taxable year beginning before January 1, 1970, a tax of 25 percent of the net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976).

(3) *Cross references.* See § 1.1-2(a) for rule relating to the computation of the limitation on tax in cases where the alternative tax is imposed. See § 1.34-2 (a) for rule relating to the computation of the dividend received credit under section 34 (for dividends received on or before December 31, 1964), and § 1.35-1 (a) for rule relating to the computation of credit for partially tax-exempt interest under section 35 in cases where the alternative tax is imposed.

(c) *Tax-exempt trusts and organizations.* In applying section 1201 in the case of tax-exempt trusts or organizations subject to the tax imposed by section 511, the only amount which is taken into account as capital gain or loss is that which is taken into account in computing unrelated business taxable income under section 512. Under section 512, the only amount taken into account as capital gain or loss is that resulting from the application of section 631(a), relating to the election to treat the cutting of timber as a sale or exchange.

(d) *Joint returns.* In the case of a joint return, the excess of any net long-term capital gain over any net short-term capital loss is to be determined by combining the long-term capital gains and losses and the short-term capital gains and losses of the spouses.

(e) *Computation of tax on capital gain in excess of subsection (d) gain*—(1) *In general.* The tax computed for purposes of section 1201(b)(3) and paragraph (b)(2)(ii)(b) of this section shall be the amount by which a tax determined under section 1 or 511 on an amount equal to the taxable income (but not less than 50 percent of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977)) for the taxable year exceeds a tax determined under section 1 or 511 on an amount equal to the sum of (i) the amount subject to tax under section 1201 (b)(1) and paragraph (b)(2)(i) of this section for such year plus (ii) an amount equal to 50 percent of the subsection (d) gain for such year.

(2) *Limitation.* Notwithstanding subparagraph (1) of this paragraph, the tax computed for purposes of section 1201(b)(3) and paragraph (b)(2)(ii)(b) of this section shall not exceed an amount equal to the following percentage of the excess of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977) over the subsection (d) gain for the taxable year:

(i) 29½ percent, in the case of a taxable year beginning after December 31, 1969, and before January 1, 1971, or

(ii) 32½ percent, in the case of a taxable year beginning after December 31, 1970, and before January 1, 1972.

(f) *Definition of subsection (d) gain*—(1) *In general.* For purposes of section 1201 and this section, the term *subsection (d) gain* means the sum of the long-term capital gains for the taxable year arising:

(i) In the case of amounts received or accrued, as the case may be, before January 1, 1975 (other than any gain from a transaction described in section 631 or 1235), from:

(a) Sales or other dispositions on or before October 9, 1969, including sales or other dispositions the income from which is returned as provided in section 453 (a)(1) or (b)(1), or

(b) Sales or other dispositions after October 9, 1969, pursuant to binding contracts entered into on or before that date, including sales or other dispositions the income from which is returned as provided in section 453 (a)(1) or (b)(1),

(ii) From liquidating distributions made by a corporation which are made (a) before October 10, 1970, and (b) pursuant to a plan of complete liquidation adopted on or before October 9, 1969, or

(iii) In the case of a taxpayer (other than a corporation), from any other source not described in subdivision (i) or (ii) of this subparagraph, but the amount taken into account from such other sources shall be limited to the amount, if any, by which \$50,000 (\$25,000 in the case of a married individual filing a separate return) exceeds the sum of the gains to which subdivisions (i) and (ii) of this subparagraph apply.

(2) *Special rules.* For purposes of subparagraph (1) of this paragraph:

(i) A binding contract entered into on or before October 9, 1969, means a contract, whether written or unwritten, which on or before that date was legally enforceable against the taxpayer under applicable law. If on or before October 9, 1969, a taxpayer grants an irrevocable option or irrevocable contractual right to another party to buy certain property and such other party exercises that option or right after October 9, 1969, the sale of such property is a sale pursuant to a binding contract entered into on or before October 9, 1969. The application of this subdivision may be illustrated by the following example:

*Example:* During 1964, A, B, and C formed a closely held corporation, and A was appointed as president of the organization. On July 1, 1964, A received for consideration 100 shares of common stock in the corporation subject to the agreement that, if A should retire from the management of the corporation or die, A or his estate would first offer his shares of stock to the corporation for purchase and that, if the corporation did not buy the stock within 60 days, the stock could be sold to any party other than the corporation. On September 1, 1970, A retired from the management of the corporation and offered his shares to the corporation for purchase. Pursuant to the agreement, the corporation purchased A's stock on September 30, 1970. A's sale of such stock was pursuant to a binding contract entered into on or before October 9, 1969.

(ii) A contract which pursuant to subdivision (i) of this subparagraph constitutes a binding contract entered into on or before October 9, 1969, does not cease to qualify as such a contract

by reason of the fact that after October 9, 1969, there is a modification of the terms of the contract such as a change in the time of performance, or in the amount of the debt or in the terms and mode of payment, or in the rate of interest, or there is a change in the form or nature of the obligation or the character of the security, so long as the taxpayer is at all times on and after October 9, 1969, legally bound by such contract. The application of this subdivision may be illustrated by the following examples:

*Example 1.* On August 1, 1969, A sold certain capital assets to B on the installment plan and elected to return the gain therefrom under section 453, the agreement providing for payments over a period of 2 years. At the time of the sale these assets had been held by A for more than 6 months. On July 31, 1970, A and B agreed to a modification of the terms of payment under the sales agreement, the only change in the contract being that the installment payments due after July 31, 1970, would be paid over a 3-year period. For purposes of this paragraph the payments received by A after July 31, 1970, are considered amounts received from the sale on August 1, 1969. (See section 483 for rules with respect to interest on deferred payments.)

*Example 2.* On April 1, 1969, A sold certain capital assets to B on the installment plan and elected to return the gain therefrom under section 453, the agreement providing for payments over a period of 3 years. At the time of the sale these assets had been held by A for more than 6 months. On March 31, 1970, C assumed B's obligation to pay the balance of the installments which were due after that date. For purposes of this paragraph any installment payments received by A after March 31, 1970, from C are considered amounts received from a sale made on or before October 9, 1969.

*Example 3.* On May 1, 1969, A offers to sell certain capital assets to B if B accepts the offer within 1 year, unless it is previously withdrawn by A. B accepts the offer on November 1, 1969, and the transaction is consummated shortly thereafter. For purposes of this paragraph, any payment received by A pursuant to the sale is not considered an amount received from a sale made on or before October 9, 1969, or from a sale pursuant to a binding contract entered into on or before that date.

(iii) An amount which is considered under section 402(a)(2) or 403(a)(2) as gain of the taxpayer from the sale or exchange of a capital asset held for more than 6 months shall be treated as gain subject to the provisions of sec-

tion 1201 (d)(1) and subdivision (i) of such subparagraph, but only if on or before October 9, 1969, (a) the employee with respect to whom such amount is distributed or paid, died or was otherwise separated from the service, and (b) the terms of the plan required, or the employee elected, that total distributions or amounts payable be paid to the taxpayer within 1 taxable year.

(iv) Gain described in section 1201(d)(1) or (2) with respect to a partnership, estate, or trust, which is required to be included in the gross income of a partner in such partnership, or of a beneficiary of such estate or trust, shall be treated as such gain with respect to such partner or beneficiary. Thus, for example, if during 1974 a partnership which uses the calendar year as its taxable year receives amounts which give rise to section 1201(d)(1) gain, a partner who uses the fiscal year ending June 30 as his taxable year shall treat his distributive share of such gain as subsection (d) gain for his taxable year ending June 30, 1975, even though such share is distributed to him after December 31, 1974. See § 1.706-1.

(v) An individual shall be considered married for purposes of subdivision (iii) of such subparagraph if for the taxable year he may elect with his spouse to make a joint return under section 6013(a).

(vi) In applying such subparagraph for purposes of section 21(a)(1) long-term capital gains arising from amounts received before January 1, 1970, shall be taken into account if such amounts are received during the taxable year.

(g) *Illustrations.* The application of this section may be illustrated by the following examples in which the assumption is made that section 56 (relating to minimum tax for tax preferences) does not apply:

*Example 1.* A, a single individual, has for the calendar year 1954 taxable income (exclusive of capital gains and losses) of \$99,400. He realizes in 1954 a gain of \$50,000 on the sale of a capital asset held for 19 months and sustains a loss of \$20,000 on the sale of a capital asset held for 5 months. He had no other capital gains or losses. Since the alternative tax is less than the tax otherwise computed under section 1, the tax payable is the alternative tax, that is \$74,298. The tax is computed as follows:

**Internal Revenue Service, Treasury**

**§ 1.1201-1**

Tax Under Section 1	
Taxable income exclusive of capital gains and losses .....	\$99,400
Net long-term capital gain (100 percent of \$50,000) .....	\$50,000
Net short-term capital loss (100 percent of \$20,000) .....	20,000
Excess of net long-term capital gain over the net short-term capital loss .....	30,000
	129,400
Deduction of 50 percent of excess of net long-term capital gain over the net short-term capital loss (section 1202) .....	15,000
Taxable income .....	114,400
Tax under section 1 .....	80,136
<i>Alternative Tax Under Section 1201(b)</i>	
Taxable income .....	\$114,400
Less 50 percent of excess of net long-term capital gain over net short-term capital loss (section 1201(b)(1)) .....	15,000
Taxable income exclusive of capital gains and losses .....	99,400
Partial tax (tax on \$99,400) .....	66,798
Plus 25 percent of \$30,000 .....	7,500
Alternative tax under section 1201(b) .....	74,298

*Example 2.* A husband and wife, who file a joint return for the calendar year 1970, have taxable income (exclusive of capital gains and losses) of \$100,000. In 1970 they realize \$200,000 of net long-term capital gain in excess of net short-term capital loss, including long-term capital gains of \$100,000 arising from sales consummated in 1968 the income from which is returned on the installment method under section 453, and long-term capital gains of \$50,000, arising in respect of distributions from X corporation made before October 10, 1970, which were pursuant to a plan of complete liquidation adopted on October 9, 1969. Since the alternative tax under section 1201(b) is less than the tax otherwise computed under section 1, the tax payable for 1970 is the alternative tax, that is, \$97,430 plus the tax surcharge under section 51. The tax (without regard to the tax surcharge) is computed as follows:

Tax Under Section 1	
Taxable income exclusive of capital gains and losses .....	\$100,000
Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) (excess of net long-term capital gain over the net short-term capital loss) .....	200,000
Total .....	300,000
Deduction of 50 percent of net section 1201 (net capital gain for taxable years beginning after December 31, 1976) gain (section 1202) .....	100,000
Taxable income .....	200,000
Tax under section 1 .....	110,980
<i>Alternative Tax Under Section 1201(b)</i>	
(1) Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) .....	\$200,000

(2) Subsection (d) gain:	
Section 1201(d)(1) .....	100,000
Section 1201(d)(2) .....	50,000
Total subsection (d) gain .....	150,000
(3) Net section 1201 (net capital gain for taxable years beginning after December 31, 1976) gain in excess of subsection (d) gain (\$200,000 less \$150,000) .....	
	50,000
(4) Tax under section 1201(b)(1):	
(i) Taxable income .....	\$200,000
(ii) Less: 50% of item (1) .....	100,000
(iii) Amount subject to tax under section 1201(b)(1) .....	100,000
Partial tax (computed under section 1) ...	45,180
(5) Tax under section 1201(b)(2): (25% of item (1) or of item (2), whichever is lesser [25% of \$150,000]) .....	
	37,500
(6) Tax under section 1201(b)(3) on item (3):	
Tax under section 1 on taxable income (\$200,000) .....	\$110,980
Less: Tax under section 1 on sum of item (4)(iii)(c) (\$100,000) plus 50% of item (2) (\$75,000) (Total \$175,000) .....	93,780
Tax under section 1201(c)(1) .....	17,200
Limitation under section.	
1201(c)(2)(A) (29½% of item (3)) .....	14,750
(7) Alternative tax under section 1201(b) .....	97,430

*Example 3.* A husband and wife, who file a joint return for the calendar year 1971, have taxable income (exclusive of capital gains and losses) of \$80,000. In 1971 they realize long-term capital gain of \$30,000 arising from a sale consummated on July 1, 1969, the income from which is returned on the installment method under section 453. From securities transactions in 1971 they have long-term capital gains of 60,000 and a short-term capital loss of \$10,000. Since the alternative tax under section 1201(b) is less than the tax otherwise computed under section 1, the tax payable is the alternative tax, that is, \$55,140. The tax is computed as follows:

Tax Under Section 1	
Taxable income exclusive of capital gains and losses .....	\$80,000
Net long-term capital gains (100% of \$90,000) .....	\$90,000
Net short-term capital loss (100% of \$10,000) .....	10,000
Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) .....	80,000
Total .....	160,000
Deduction of 50% of net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) (section 1202) .....	40,000
Taxable income .....	120,000
Tax under section 1 .....	57,580

§ 1.1202-0

26 CFR Ch. I (4-1-02 Edition)

Alternative Tax Under Section 1201(b)	
(1) Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	\$80,000
<b>(2) Subsection (d) gain:</b>	
Section 1201(d)(1)	30,000
Section 1201(d)(2)	20,000
Section 1201(d)(3) (\$50,000 less \$30,000)	20,000
Total subsection (d) gain	50,000
(3) Net section 1201 (net capital gain for taxable years beginning after December 31, 1976) gain in excess of subsection (d) gain (\$80,000 less \$50,000)	30,000
<b>(4) Tax under section 1201(b)(1):</b>	
(i) Taxable income	\$120,000
(ii) Less: 50% of item (1)	40,000
(iii) Amount subject to tax under section 1201(b)(1)	80,000
Partial tax (computed under section 1)	33,340
(5) Tax under section 1201(b)(2): (25% of item (1) or of item (2), whichever is lesser [25% of \$50,000])	12,500
<b>(6) Tax under section 1201 (b)(3) on item (3):</b>	
Tax under section 1 on taxable income (\$120,000)	\$57,580
Less: Tax under sec. 1 on sum of item (4) (iii) (\$80,000) plus 50% of item (2) (\$25,000) (Total \$105,000)	\$48,280
Tax under section 1201(c)(1)	9,300
Limitation under section 1201(c) (2)(B) (32½% of item (3))	9,750
(7) Alternative tax under section 1201(b)	55,140

*Example 4.* A husband and wife, who file a joint return for the calendar year 1973, have taxable income (exclusive of capital gains and losses) of \$250,000. In 1973 they realize long-term capital gains (not described in section 1201(d) (1) or (2)) of \$140,000 and a short-term capital loss of \$50,000. Since the alternative tax under section 1201(b) is less than the tax otherwise computed under section 1, the tax payable is the alternative tax, that is, \$172,480. The tax is computed as follows:

Tax Under Section 1	
Taxable income exclusive of capital gains and losses	\$250,000
Net long-term capital gains (100% of \$140,000)	\$140,000
Net short-term capital loss (100% of \$50,000)	50,000
Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	90,000
Total	340,000
Deduction of 50% of net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) (section 1202)	45,000
Taxable income	295,000
Tax under section 1	177,480

Alternative Tax Under Section 1201(b)	
(1) Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	\$90,000
<b>(2) Subsection (d) gain:</b>	
Section 1201(d)(1)	50,000
Section 1201(d)(2)	20,000
Section 1201(d)(3)	20,000
Total subsection (d) gain	50,000
(3) Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976) in excess of subsection (d) gain (\$90,000 less \$50,000)	40,000
<b>(4) Tax under section 1201(b)(1):</b>	
(i) Taxable income	\$295,000
(ii) Less: 50% of item (1)	45,000
(iii) Amount subject to tax under section 1201(b)(1)	250,000
Partial tax (computed under section 1)	145,980
(5) Tax under section 1201(b)(2): (25% of item (1) or of item (2), whichever is lesser [25% of \$50,000])	\$12,500
<b>(6) Tax under section 1201(b)(3) on item (3):</b>	
Tax under section 1 on taxable income (\$295,000)	\$177,480
Less: Tax under section 1 on sum of item (4) (iii) (\$250,000) plus 50% of item (2) (\$25,000) (Total \$275,000)	163,480
(Total \$275,000)	14,000
(7) Alternative tax under section 1201(b)	172,480

[T.D. 7337, 39 FR 44975, Dec. 30, 1974, as amended by T.D. 7728, 45 FR 72651, Nov. 3, 1980]

§ 1.1202-0 Table of contents.

This section lists the major captions that appear in the regulations under § 1.1202-2.

§ 1.1202-2 Qualified small business stock; effect of redemptions.

(a) Redemptions from taxpayer or related person.

(1) In general.

(2) De minimis amount.

(b) Significant redemptions.

(1) In general.

(2) De minimis amount.

(c) Transfers by shareholders in connection with the performance of services not treated as purchases.

(d) Exceptions for termination of services, death, disability or mental incompetency, or divorce.

(1) Termination of services.

(2) Death.

(3) Disability or mental incompetency.

(4) Divorce.

(e) Effective date.

[T.D. 8749, 62 FR 68166, Dec. 31, 1997]

§ 1.1202-1 Deduction for capital gains.

(a) In computing gross income, adjusted gross income, taxable income, capital gain net income (net capital