

basis of the account on such date shall be the issue price, and the redemption price shall equal the amount actually on deposit in the account on such date plus the amount which would be credited to such account assuming the issuer, during the remaining term of such account, continues to credit contingent interest at the new rate.

(iii) *Adjustment for reduced interest.* If for any period the actual rate of interest at which contingent interest is credited to the depositor's account is less than the rate for the previous period taken into account under this subparagraph in computing the redemption price, the difference between the amount of interest which would have been credited to the account at the rate for such previous period and the amount actually credited shall be allowed as a deduction against the amount of original issue discount with respect to such account required to be included in the gross income of the depositor. If an account is redeemed for a price less than the adjusted basis of the account, the depositor shall be allowed as a deduction, in computing adjusted gross income, the amount of the original issue discount he included in gross income but did not receive.

(f) *Application of section 1232(a)(3) to face-amount certificates—(1) In general.* Under paragraph (c)(3) of § 1.1232-1, the provisions of section 1232(a)(3) and this section apply in the case of a face-amount certificate issued after December 31, 1975 (other than such a certificate issued pursuant to a written commitment which was binding on such date and at all times thereafter).

(2) *Relationship with paragraph (e) of this section.* Determinations with regard to the inclusion as interest of original issue discount on, and certain adjustments with respect to, face-amount certificates to which this section applies shall be made in a manner consistent with the rules of paragraph (e) of this section (relating to the application of section 1232 to certain deposits in financial institutions and similar arrangements). Thus, for example, if a face-amount certificate is redeemed before maturity, the holder shall be allowed a deduction in computing adjusted gross income computed in a manner consistent with the rules

of paragraph (e)(2) of this section. For a further example, if under the terms of a face-amount certificate, the issuer may grant additional credits to be paid at a fixed maturity date, computations with respect to such additional credits shall be made in a manner consistent with the rules of paragraphs (e) (6) and (7) of this section (as applicable) relating to contingent interest arrangements.

[T.D. 7154, 36 FR 25005, Dec. 28, 1971; 37 FR 527, Jan. 13, 1972, as amended by T.D. 7213, 37 FR 21993, Oct. 18, 1972; 37 FR 22863, Oct. 26, 1972; T.D. 7311, 39 FR 11880, Apr. 1, 1974; T.D. 7365, 40 FR 27936, July 2, 1975]

§ 1.1232-4 Obligations with excess coupons detached.

Section 1232(c) provides that if an obligation which is issued at any time with interest coupons:

(a) Is purchased after August 16, 1954, and before January 1, 1958, and the purchaser does not receive all the coupons which first become payable more than 12 months after the date of the purchase, or

(b) Is purchased after December 31, 1957, and the purchaser does not receive all the coupons which first become payable after the date of purchase,

Any gain on the later sale or other disposition of the obligation by the purchaser (or by a transferee of the purchaser whose basis is determined by reference to the basis of the obligation in the hands of the purchaser) shall be treated as ordinary income to the extent that the fair market value of the obligation (determined as of the time of the purchase) with coupons attached exceeds the purchase price. If both the preceding sentence and section 1232(a)(2) apply with respect to the gain realized on the retirement or other disposition of an obligation, then section 1232(a)(2) shall apply only with respect to that part of the gain to which the preceding sentence does not apply. For example, a \$100 bond which sells at \$90 with all its coupons attached is purchased by A for \$80 with 3 years' coupons detached. Three years later, A sells the bond for \$92. The first \$10 of the \$12 profit is taxable as ordinary income. The remaining \$2 gain is taxable either as ordinary income or as long-term capital gain, depending upon the

application of section 1232(a)(2). Pursuant to section 7851(a)(1)(C), the regulations prescribed in this section shall also apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953, although such years are subject to the Internal Revenue Code of 1939.

[T.D. 7154, 36 FR 25009, Dec. 28, 1971]

§ 1.1233-1 Gains and losses from short sales.

(a) *General.* (1) For income tax purposes, a short sale is not deemed to be consummated until delivery of property to close the short sale. Whether the recognized gain or loss from a short sale is capital gain or loss or ordinary gain or loss depends upon whether the property so delivered constitutes a capital asset in the hands of the taxpayer.

(2) Thus, if a dealer in securities makes a short sale of X Corporation stock, ordinary gain or loss results on closing of the short sale if the stock used to close the short sale was stock which he held primarily for sale to customers in the ordinary course of his trade or business. If the stock used to close the short sale was a capital asset in his hands, or if the taxpayer in this example was not a dealer, a capital gain or loss would result.

(3) Generally, the period for which a taxpayer holds property delivered to close a short sale determines whether long-term or short-term capital gain or loss results.

(4) Thus, if a taxpayer makes a short sale of shares of stock and covers the short sale by purchasing and delivering shares which he held for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), the recognized gain or loss would be considered short-term capital gain or loss. If the short sale is made through a broker and the broker borrows property to make a delivery, the short sale is not deemed to be consummated until the obligation of the seller created by the short sale is finally discharged by delivery of property to the broker to replace the property borrowed by the broker.

(5) For rules for determining the date of sale for purposes of applying under section 1091 the 61-day period applica-

ble to a short sale of stock or securities at a loss, see paragraph (g) of § 1.1091-1.

(b) *Hedging transactions.* Under section 1233(g), the provisions of section 1233 and this section shall not apply to any bona fide hedging transaction in commodity futures entered into by flour millers, producers of cloth, operators of grain elevators, etc., for the purpose of their business. Gain or loss from a short sale of commodity futures which does not qualify as a hedging transaction shall be considered gain or loss from the sale or exchange of a capital asset if the commodity future used to close the short sale constitutes a capital asset in the hands of the taxpayer as explained in paragraph (a) of this section.

(c) *Special short sales*—(1) *General.* Section 1233 provides rules as to the tax consequences of a short sale of property if gain or loss from the short sale is considered as gain or loss from the sale or exchange of a capital asset under section 1233(a) and paragraph (a) of this section and if, at the time of the short sale or on or before the date of the closing of the short sale, the taxpayer holds property substantially identical to that sold short. The term *property* is defined for purposes of such rules to include only stocks and securities (including stocks and securities dealt with on a *when issued* basis) and commodity futures, which are capital assets in the hands of the taxpayer. Certain restrictions on the application of the section to commodity futures are provided in section 1233(e) and paragraph (d)(2) of this section. Section 1233(f) contains special provisions governing the operation of rule (2) in subparagraph (2) of this paragraph in the case of a purchase and short sale of stock (as defined in subparagraph (3) qualifying as an arbitrage operation. See paragraph (f) of this section for detailed rules relating to arbitrage operations in stocks and securities.

(2) *Treatment of special short sales.* The first two rules, which are set forth in section 1233(b), are applicable whenever property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in