



**U.S. Securities Markets Coalition Opposes
Senator Wyden’s Proposed Amendment
“Modernization of Derivatives Tax Act of 2017”**

The members of the U.S. Securities Markets Coalition (the “**Coalition**”)¹ write to share our opposition to Senator Wyden’s filed amendment (Wyden #11, Committee #155) to the Chairman’s Mark of the Tax Cuts and Jobs Act² that would add the language of his proposed Modernization of Derivatives Tax Act of 2017 (“MODA 2017”).

The Coalition has previously shared its views with the Committee and with Senator Wyden that while we applaud Senator Wyden’s stated interest in “radically simplifying” the tax code to create “a simpler, more straightforward tax regime,”³ we respectfully believe that MODA 2017 would not advance this objective, but instead would create results that are neither simple, nor straightforward, nor fair, as applied to exchange-traded (*i.e.*, listed) options.

Options have been traded on national securities exchanges in the U.S. for over 40 years, and the basic tax rules for exchange-traded options continue to work well for our millions of customers, and for the country as a whole. The Coalition believes that it is far better to “modernize” the taxation of derivatives, by identifying those specific areas where the rules fall short, and by providing limited guidance and reform in those specific areas. If Congress deems

¹ The members of the Coalition include all of the major options exchanges in the United States. The members of the Coalition are: Cboe Global Markets, NASDAQ OMX PHLX, NASDAQ Options Market, NYSE Amex Options, NYSE Arca Options, and The Options Clearing Corporation (OCC). All of these members are regulated by the Securities and Exchange Commission, and OCC is also regulated by the Commodity Futures Trading Commission and The Board of Governors of the Federal Reserve.

² MODA 2017 was introduced by Senator Wyden on May 2, 2017, as S. 1005. Legislative text of the bill can be found at:
[https://www.finance.senate.gov/imo/media/doc/S.%201005_Modernization%20of%20Derivatives%20Tax%20Act%20TEXT%20\(FRA17032\).pdf](https://www.finance.senate.gov/imo/media/doc/S.%201005_Modernization%20of%20Derivatives%20Tax%20Act%20TEXT%20(FRA17032).pdf)

³ See Senator Wyden’s statement of May 2, 2017, at:
<https://www.finance.senate.gov/imo/media/doc/MODA%20Section-by-Section%202017.pdf>

broad reform to be necessary, we strongly urge that exchange-traded options be excluded from the types of derivatives to which MODA 2017 would apply. Currently, the tax treatment of exchange-traded options is governed by well-established rules that are relatively simple and easy to understand. These rules were summarized in Revenue Ruling 78-182, not long after options first traded on a national securities exchange. These rules have worked well for decades, and we are aware of no significant concerns or uncertainties in their application. The fact that the rules are old, is no argument for replacing them, particularly when the options to which they apply are essentially the same as when the rules were promulgated. In this regard, exchange-traded options are not new or exotic instruments with troubling tax characteristics. All major tax policy goals – simplicity, fairness, efficiency and administrability – support retention of the current-law treatment of exchange-traded options over the approach set forth in MODA 2017.

Broad-brush reform of the nature represented by MODA 2017 will create new, untold complexities, while at the same time, generating unfair results in many circumstances with regard to exchange-traded options.

First, the Coalition is concerned that MODA 2017 would tax users of exchange-traded options with respect to “phantom income” in advance of their receipt of cash to pay tax. This reflects a dramatic departure from established tax norms, but does not reflect the dramatic simplification that the proposal promises. Even in situations where a taxpayer executes an exchange-traded option by itself (*i.e.*, without any position in the stock underlying the option), MODA 2017 will create unwarranted complexity and fairness issues. While market values for actively traded exchange-traded options are readily observable, that is not necessarily true for thinly traded options. Options are exchange-traded on roughly 3,700 individual stocks, ETFs and equity-related indexes, and there are numerous options with respect to each of those underliers (*i.e.*, puts and calls with various exercise prices and expiration dates).⁴ For many of these individual options, there may be no trades for weeks at a time. In such situations, and others that arise frequently in practice, there may be differences of opinion regarding a reasonable approximation of market value. We believe that conflict with the IRS regarding valuation will become commonplace. Thus, MODA 2017 will create serious burdens in administrability of the tax system. Imposing such burdens is needless. The current system works well, because (among other reasons) it accounts for taxpayers’ income/loss from exchange-traded options when those amounts are certain, and not subject to valuation debates. (The current realization-based system also does not impose tax on “phantom income,” that may never be earned because of market movements that occur in a subsequent tax year.) Moreover, marking exchange-traded options to market will result in a higher effective tax rate for exchange-traded options, as compared to stocks (which are not marked). Exchange-traded options will thus be “tax disadvantaged” relative to stocks (and short sales).⁵ Instead, it is entirely reasonable and appropriate to apply a

⁴ There are currently about 850,000 options “series” listed on U.S. options exchanges. Each series consists of a call option or a put option with a specific exercise price and a specific expiration date.

⁵ See, David Weisbach, “A Partial Mark-to-Market System,” 53 Tax L. Rev. 95, 100 (1999) (assets that are marked to market have higher effective tax rate than assets that are taxed based on realization principles; therefore, mark-to-market assets must have a lower nominal rate than realization assets in order to equalize effective tax rates). For this reason, we think it is problematic that MODA 2017 would repeal the “60/40 tax treatment” of section 1256. Section 1256 requires that certain listed options (generally broad-based index options that compete with futures contracts) be

lower nominal rate to assets that are marked-to-market, in order equalize the effective tax rate between realization-based assets and mark-to-market assets.

Second, and perhaps even more concerning to the Coalition, is that MODA 2017 would (A) impose a substantial, and needless, tax penalty (*i.e.*, triggering gain on underlying stock that is not actually sold) on individuals and other taxpayers who commonly use exchange-traded options to reduce the risks of owning stocks or to generate additional income from their stock holdings; and (B) create a tremendous amount of administrative and legal complexity (thereby failing to achieve the proposal's stated goals).

In summary, MODA 2017 would impose significant, and unfair, tax costs and complexities on taxpayers who use exchange-traded options. These costs, in turn, would greatly harm the exchange-traded options markets. Liquidity would be reduced and trading costs would increase. Repercussions would be felt in the underlying stock markets, as investors and other market participants would be unable to allocate efficiently the risks associated with owning stock. As applied to exchange-traded options, MODA 2017 would distort economic decision-making and replace the well-established and relatively simple tax rules for options with a harsh, burdensome and overly complicated regime.

For these reasons, we urge you to oppose Senator Wyden's amendment #11 to the Chairman's Mark of the Tax Cuts and Jobs Act.

If you have any questions or would like additional information from the coalition, please contact Julie Bauer, Senior Vice President of Government Relations for the Options Clearing Corporation, at jbauer@theocc.com, or at 202-971-7235.

marked-to-marked, and that the resulting gain/loss be treated as 60% long-term gain/loss and 40% short-term gain/loss.