

The Administration Proposal to Repeal Current Law Treatment of Dealers of Equity Options and Commodities

The Chicago Mercantile Exchange (CME), Chicago Board of Trade (CBOT), New York Mercantile Exchange (NYMEX), and COMEX urge rejection of a proposal by the Administration to eliminate 60/40 treatment for Commodity Dealers and Options Dealers. The Administration's proposal would impose a very substantial increase in tax rates applicable to the individuals who are most responsible for creating liquid and efficient regulated markets. Moreover, there is no legitimate basis to support the claim that 60/40 treatment for registered market makers should be classified as a tax loophole.

Under current law, gains and losses derived from trading futures contracts and certain other so-called section 1256 contracts are treated as 60 percent long term capital gains and losses and 40 percent short term gains and losses. This includes unrealized gains and losses from these contracts which are marked to market at the end of the year. The Administration proposes to repeal 60/40 treatment and treat all gains and losses as ordinary. (Administration's FY 2011 Revenue Proposals.)

- **THE PROPOSAL IS NOT A LOOPHOLE CLOSER:** This proposed tax increase cannot be regarded as a “loophole closer” or some “fix” of an unintended tax result. The current 60/40 tax regime was enacted for futures transactions in 1981 (and for certain options transactions in 1984) as part of a conscious Congressional policy that created a mark-to-market tax accounting system for such contracts under which the annual appreciation in contract positions is taxed, irrespective of whether gains have actually been realized by closing out the contract positions. The 60/40 blended rate formula was intended to compensate for the imposition of tax on unrealized gains and the practical inability of affected taxpayers to qualify for the holding period (greater than one year) normally required for long-term capital gains treatment. Under the proposal, the 60/40 benefit would be eliminated for exchange members, but the mark-to-market detriment and the inability to get long-term capital gains would remain.
- **THE PROPOSAL WILL IMPAIR THE ABILITY OF EXCHANGES TO PERFORM THEIR MANDATED RESPONSIBILITIES:** In addition to inflicting a sizable tax burden on individual traders, the proposal would harm the customers of U.S. financial markets and impair effective price discovery, which is critical to the general economy. The taxpayers – so-called “commodities and options dealers” with respect to the futures exchanges – are exchange members who provide liquidity that is essential to an efficient marketplace. These professional traders put their capital at risk in high velocity, high volume trades that makes it possible for hedgers to transfer business and investment risks (such as the risks associated with stock portfolios, interest rates, farming operations and foreign currency fluctuations) to the professional traders at fair market prices. Imposing a substantial tax increase on the core participants in the U.S. futures and options markets would be costly to such hedgers and strike a blow against the U.S. exchanges in their international competition.
- **FEWER, LESS CAPITALIZED MARKET MAKERS INCREASE COSTS FOR MARKET USERS:** The public customer, who uses futures markets to hedge and manage risk, is best served by efficient, liquid markets. The performance of regulated futures markets and regulated clearing houses during the current

economic crisis has been outstanding and public customers have been the beneficiaries of that performance. This is not the time to tamper with the balance that fostered that high level of performance. We join with all of the other regulated derivative exchanges to urge the Administration and Congress to preserve the balance that allowed exchanges to operate so effectively during the recent market turmoil.

- **MOST OF THE TAX INCREASE ON FUTURES IMPACTS CHICAGO AND NEW YORK CITY FIRMS:** These are firms that survived the financial crisis without government assistance and are currently hiring high quality, highly paid employees. These firms are renting new office space in the suffering real estate market, making large capital investments and are, with their employees and owners, making major contributions to the tax revenues of the municipal, county and state governments.