

Updated US list of foreign currency futures contracts - starting point for Section 1256

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This International Tax Alert provides an updated list of foreign currencies that are traded on qualified boards or exchanges for purposes of beginning the analysis whether an over-the-counter contract (OTC) with respect to those currencies should be marked to market under Internal Revenue Code¹ Section 1256.² The list contained in this Alert updates the prior year's list of foreign currency futures contracts. It is important to note that this list is retrospective; currencies can begin (or cease) trading in futures at any time. Thus, it is imperative for taxpayers to examine contemporaneous futures trading to determine whether a specific contract will qualify as a Section 1256 contract.

Warning: This Alert lists all currencies for which there was a known regulated futures contract (RFC) offered for trading. A lack of actual trading in the RFC affects whether an OTC contract can be considered a Section 1256 contract. Some RFCs on the list appear to have had no trades in 2019. A complete lack of RFC trades (or perhaps sporadic trades or limited volume) would prevent OTC contracts from qualifying as Section 1256 contracts. **Therefore, the list should not be viewed as definitive, but rather as a starting point in the analysis.**

Under Section 1256(a)(1), each Section 1256 contract held by a taxpayer at the close of the tax year must be marked-to-market. The term Section 1256 contract includes, among other things, any foreign currency contract.³ The term foreign currency contract is defined under Section 1256(g)(2)(A) as a contract that:

- Requires delivery of, or the settlement of which depends on the value of, a foreign currency that is a currency in which positions are also traded through regulated futures contracts
- Is traded on the interbank market
- Is entered into at an arm's-length price determined by reference to the price in the interbank market

The legislative history provides that the statutory definition is intended to describe the characteristics of bank forward contracts used for trading currencies.

The following is a list of currencies in which positions are currently listed through regulated single futures contracts, or cross currency pairs, as of the date of this Alert. As noted below, although each of these contracts is listed, some show little or no trading in the past year.

1. Australian dollar
2. Brazilian real
3. British pound
4. Canadian dollar
5. Chilean peso
6. Chinese renminbi⁴
7. Colombian peso
8. Czech koruna
9. Euro
10. Hungarian forint
11. Israeli shekel
12. Indian rupee
13. Japanese yen
14. Korean won
15. Mexican peso
16. New Zealand dollar
17. Norwegian krone
18. Polish zloty
19. Russian ruble
20. South African rand
21. Swedish krona
22. Swiss franc
23. Turkish lira

As described above, provided that there is sufficient trading of these currencies through regulated futures contracts, and the additional conditions described in Section 1256(g)(2)(A) are satisfied, foreign currency contracts with respect to these currencies should be marked to market under Section 1256(a)(1). Certain currencies, while listed above as being offered for trading, had little or no actual trading in 2019. For example, the Chilean peso future and Colombian peso had limited trading. Additionally, while there was minimal trading in the Norwegian krone, Swedish krona, Israeli shekel, Czech koruna, Hungarian forint, and Polish zloty single futures contracts, there was active trading in the cross-currency pair contracts that involved those currencies. Therefore, it is important that a taxpayer understand the RFC trading environment around the time it enters into any OTC foreign currency contract, as well as the trading environment throughout the life of the contract.

Please consult with one of the individuals listed below before adopting the position that Section 1256 does or does not apply to any particular foreign currency contract. As described above, this list is subject to change on an ongoing basis as new foreign currencies begin to trade in the regulated futures market and as trading in other foreign currencies becomes thin or nonexistent.

Scope

It is important to note that this list does not immediately reflect changes in the status of foreign currencies but is instead generally updated only annually. Please contact one of the individuals listed below before adopting or changing a position with respect to whether Section 1256 applies to a particular currency.

Endnotes

1. All “Section” references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. What constitutes a foreign currency contract has traditionally been limited to foreign currency forwards. See Notice 2007-71, in which the Internal Revenue Service states that it and the Treasury Department do not believe that foreign currency options are foreign currency contracts as defined in Section 1256(g)(2). Whether foreign currency options are included in Section 1256 is now uncertain given *Wright v. Commissioner*, 809 F.3d 877 (6th Cir. 7 January 2016), where the Sixth Circuit held that OTC foreign currency options could be foreign currency contracts.
3. Section 1256(b)(1)(B).
4. Note that while there is a single currency, renminbi, there are both offshore and onshore rates. We could not find any listing of futures contracts based on the onshore currency rate on an Section 1256 qualified board or exchange.

For additional information with respect to this Alert, please contact the following:

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