Wyden-Grassley Oil Speculation Tax Proposal Section-by-Section

Section 1 – For taxpayers -- treat any capital gain or loss from the sale or exchange of oil or natural gas and related commodities for investment purposes as short-term capital gain or loss, regardless of the holding period. This would apply to (a) oil or natural gas or any of their primary products that are actively traded; (b) any index fund substantial portion of which is based on one or more of these commodities; (c) any notional principal contract related to such indexes or commodities; and (d) any related option, forward contract, futures contract, short position, or similar instrument.

It would not affect taxpayers who already treat such gain or loss as ordinary income or loss; including (a) dealers in commodities, (b) those who handle the commodity as inventory; (c) businesses that sell or exchange the commodity as part of genuine commercial hedging transactions; and (d) persons who regularly use or consume the commodity in the ordinary course of their trade or business.

It would apply to taxpaying investors who recognize gain or loss on the sale or exchange of an interest in a partnership, such as a hedge fund, or investments in commodity index funds that hold substantial amounts of one or more of these commodities or contracts or options to buy these commodities.

The bill makes a number of technical changes to the tax code to ensure that there are no loopholes. For example, the new rules apply to any gain or loss from oil and natural gas related trades under section 1256 – which applies to a subset of commodity-related trades that are marked-to-market at the end of each tax year. Under our proposal, all section 1256 gains would be treated as 100 percent short-term capital gain. At present, these are 60 percent short-term and 40 percent long-term. This would also apply to section 1256 contract losses that are carried back against prior gains.

This bill would apply to investments made on or after the date of the public release of the bill – July 31, 2008. Investments that have already been made will not be impacted, but new speculative commodity investments that are made after investors are on notice that we intend to change the tax code will be covered by the new rules.

Section 2 -- For tax-exempt entities -- treat tax-exempt entities' gains and losses from such trades as unrelated business taxable income (UBTI) under section 512. This would require tax-exempt entities to pay tax on oil and natural gas commodity investments as if they were not tax exempt. To stop the use of a foreign blocker corporation to evade UBTI treatment, the bill includes a look-through rule. This would treat income from the blocker corporation to the tax exempt as UBTI if it would have been UBTI when earned directly. Also, if tax exempts sell the stock of a foreign corporation that invests in oil and gas commodities, the relevant portion of this income would be taxed as UBTI.

Section 3 -- Study of the tax treatment of energy commodities and section 1256 contracts. The Treasury Department will conduct a study of the impact of these new provisions on commodity markets and the tax system and make recommendations on any changes that should be made. The Treasury study will be due January 1, 2012 – one year before the provisions expire.