

TAX TREATMENT FOR VOLATILITY PRODUCTS: OPTIONS, FUTURES ETFs, AND ETNs



Sep. 12, 2017 @ 12:00 pm EST
(Interactive Brokers Webinar)

Presenter:

Robert A. Green,
CPA

Managing Member

GNM TraderTax
GREEN, NEUSCHWANDER & MANNING, LLC

green TraderTax



Robert A. Green CPA

Job:

- Managing Member of Green, Neuschwander & Manning, LLC, a tax and accounting firm catering to traders and investment managers. CEO of GreenTraderTax.com.

Focus on traders:

- Trading is a real profession, and other tax professionals and solution providers underserve them. Traders deserve tax advice from CPAs and tax attorneys who are acutely aware of different tax laws and regulations that apply to them.

Robert Green's content

- Mr. Green is a leading authority on trader tax. He is the author of Green's 2017 Trader Tax Guide, which GreenTraderTax published as an annual tax guide every year since 1997.
- Mr. Green has been a contributor to Forbes.com since 2010. Mr. Green wrote the "Business of Trading" column for Active Trader magazine for 14 years until the magazine closed in 2015. Leading brokerage firms and other financial media feature Mr. Green's blog posts and Webinar content.

Robert Green's media

- Mr. Green is frequently interviewed and has appeared in Barron's, New York Times, Wall Street Journal, and several other media. Mr. Green has also appeared on CNBC, Bloomberg Television, and Forbes.com Video Network.
- Mr. Green is the chief tax speaker at Traders Expo and taught "Trader Tax 101" for CCH to tax professionals.

Webinar disclaimers

- This information is educational. It is not intended to be a substitute for specific individualized tax, legal, or investment planning advice.
- Where specific advice is necessary or appropriate, you may wish to consult with a qualified tax advisor, CPA, attorney, financial planner, or investment manager.
- Robert A. Green and the Green companies are not affiliated with Interactive Brokers.
- This presentation is based on current tax law, and tax reform changes may occur in 2017 or 2018.

Tax Treatment For Volatility Products: Options, Futures, ETFs, and ETNs

- On annual tax form 1099-B, several brokerage firms report various options on volatility products as "equity options" taxed as securities. Robert A. Green, CPA, makes a case to treat many of these options as "non-equity options" in Section 1256 ushering in lower 60/40 tax rates. Learn when and how it's possible to accomplish this treatment.
- Join Robert to learn the different tax treatment for CBOE-listed futures and options on various CBOE VIX Indexes, and CBOE-listed options on VIX ETFs and VIX ETNs. Plus, tax treatment for the underlying VIX ETFs and ETNs.

OVERVIEW

There are many different types of volatility products to trade; tax treatment varies, and some of it is unclear.

Large variety of volatility products

- There is an extensive range of volatility products to trade, listed on futures and securities exchanges, structured as options, futures, ETFs, and ETNs.
- The CBOE created several VIX Indexes across asset classes and it lists options and futures to trade on those non-tradable VIX Indexes.
- I address the top 12 list of volatility ETFs and ETNs including ETFs from ProShares and Rex, and ETNs from Barclays iPath and VelocityShares.
- CBOE lists options on volatility ETFs and ETNs.

CBOE-LISTED VIX OPTIONS AND FUTURES

CBOE has VIX Indexes across many asset classes, and it lists options and futures on those non-tradable indexes.

CBOE's VIX information

- Volatility products are designed to reflect investors' consensus view of future expected volatility in a given market index or individual financial instrument. Volatility products are considered the market's "fear gauge."
- The VIX Index is the centerpiece of CBOE Holdings' volatility franchise, which includes volatility indexes on broad-based stock indexes, exchange traded funds, individual stocks, commodities and several strategy and performance based indexes, as well as tradable volatility contracts, such as VIX options and futures.
- Visit: <http://www.cboe.com/products/vix-index-volatility>.

CBOE-listed futures on VIX Indexes

- The CFE-traded VIX futures are “regulated futures contracts” (RFCs) on a qualified board or exchange (QBE), and Section 1256 includes RFCs.
- Section 1256 carves out single stock futures, but VIX futures are not single stock futures.

CBOE-listed options on VIX Indexes

- IRS guidance is unclear about options on VIX indexes, so these general rules should apply.
- CBOE-listed options on non-tradable VIX Indexes are likely Section 1256 contracts.
- CBOE-listed options on VIX Indexes are not “equity options,” referencing a single equity price or narrow-based index of equity prices.
- They are likely "non-equity options" included in Section 1256, which references a barometer VIX Index, which does not contain equity prices.

CBOE-listed options on ETFs & ETNs

- CBOE-listed options on VIX securities ETFs, structured as registered investment companies (RICs), are likely equity options because a security ETF RIC acts like a single equity.
- CBOE-listed options on VIX commodity ETFs, structured as publicly traded partnerships (PTPs), are likely non-equity options because a commodity ETF PTP is not a single equity or narrow-based equity index.
- CBOE-listed options on VIX ETNs are likely non-equity options because an ETN is not a single equity or narrow-based equity index. An ETN is a prepaid executory contract.

Definition of a narrow-based index

- The values of a narrow-based index must reference actual equity prices. The CBOE-listed options on VIX Indexes do not reference equity prices, so they do not meet the definition of a narrow-based index.
- Even the CBOE VIX Index for an individual equity (VXAPL) does not reference the equity price of APL, but rather the VIX barometer index for APL. Therefore, it's likely that VXAPL is also a Section 1256 contract.

TAX ADVANTAGES OF SECTION 1256 CONTRACTS

Section 1256 contracts have lower 60/40 capital gains tax rates, summary reporting, and a one-page 1099-B.

Section 1256 tax savings

- These contracts have lower 60/40 capital gains tax rates, meaning 60% (including day trades) are taxed at the lower long-term capital gains rate, and 40% are taxed at the short-term rate, which is the ordinary tax rate.
- At the maximum tax brackets for 2016, the top Section 1256 contract tax rate is 28% — 12% lower than the top ordinary rate of 39.6%.
- 60/40 rates table:
- <https://greentradertax.com/trader-tax-center/tax-treatment/section-1256-contracts/>

Section 1256 contracts include:

- U.S. futures (regulated futures contracts) and options on futures. (Includes CFE-listed futures on VIX Indexes.)
- Broad-based indexes and options on broad-based indexes. (The VIX Indexes are non-tradable so this category is not used.)
- Non-equity options. (Includes CBOE-listed options on VIX Indexes, options on VIX commodity ETFs PTP and options on VIX ETNs.)

EXCHANGE TRADED FUNDS (ETFs)

Issuers organize volatility ETFs as registered investment companies (RIC) or publicly traded partnerships (PTP). Tax treatment varies by the structure.

Securities ETFs

- Securities ETFs are registered investment companies (RICs).
- Selling a securities ETF is deemed a sale of a security, calling for short-term and long-term capital gains tax treatment using the realization method.
- RIC ETFs often make short-term and long-term capital gains distributions to holders.

Securities ETF symbols

- REX volatility ETFs are RICs.
- REX VoIMAXX Long VIX Weekly Futures Strategy ETF
(**VMAX**)
-
- REX VoIMAXX Short VIX Weekly Futures Strategy ETF
(**VMIN**)
- Brokers report securities ETF proceeds and cost basis for each transaction on Form 1099-B.

Commodities/Futures ETFs

- Commodities/Futures ETFs use the publicly traded partnership (PTP) structure, also known as master limited partnerships (MLPs).
- PTPs issue annual Schedule K-1s passing through income or loss, including Section 1256 income or loss from trading within the PTP.
- Selling a commodity ETF is deemed a sale of a security, calling for short-term and long-term capital gains tax treatment using the realization method.

Commodities/Futures ETFs

- Taxpayers invested in commodities/futures ETFs should adjust cost-basis on Form 8949 (capital gains and losses and other income or loss), ensuring they don't double count Schedule K-1 pass through income or loss.
- Form 1099-B does not make this cost-basis adjustment, so investors need to make a manual adjustment.

Volatility ETFs organized as PTPs

- ProShares VIX Short-Term Futures ETF (**VIXY**) S&P 500® VIX Short-Term Futures Index
- ProShares VIX Mid-Term Futures ETF (**VIXM**) S&P 500® VIX Mid-Term Futures Index
- ProShares Ultra VIX Short-Term Futures ETF (**UVXY**) S&P 500® VIX Short-Term Futures Index
- ProShares Short VIX Short-Term Futures ETF (**SVXY**) S&P 500® VIX Short-Term Futures Index
- All are listed on the NYSE Arca securities exchange.

Options on ETFs

- The IRS hasn't explicitly stated tax treatment on sales of options based on ETFs. I suggest the following:
- Options on Securities ETF (RICs) are likely taxed as securities since an RIC is like an equity or a security.
- QBE-listed options on commodities/futures ETFs (PTP) are likely Section 1256 contracts since they are non-equity options. The PTP is not a single equity symbol or narrow-based equity index.

EXCHANGE TRADED NOTES (ETNS)

ETN tax treatment is similar to ETFs, yet there are fundamental differences.

Exchange Traded Notes (ETNs)

- An Exchange Traded Note (ETN) calculates its rate of return or interest rate based on the movement of an underlying financial instrument, futures index, or equities index.
- In IRS jargon, an ETN is a prepaid executory contract or prepaid forward contract based on the relevant financial instrument or index.
- An ETN is not a security or a commodity, so it should not qualify for Section 475 ordinary gain or loss treatment used by traders eligible for trader tax status and who elected Section 475 on time.

Exchange Traded Notes (ETNs)

- The ETN holder does not own an underlying instrument or futures index, so he or she should not use Section 1256 treatment.
- Report ETN income when realized (sold) as short-term and long-term capital gains and losses.
- Exception: Report currency ETNs with Section 988 ordinary gain or loss treatment.

VXX prospectus tax treatment

“**Investors agree** to treat all iPath ETNs, except certain currency ETNs, as prepaid executory contracts with respect to the relevant index. If such iPath ETNs are so treated, investors should recognize gain or loss upon the sale, redemption or maturity of their iPath ETNs in an amount equal to the difference between the amount they receive at such time and their tax basis in the securities.

Investors generally agree to treat such gain or loss as capital gain or loss, except with respect to those (currency) iPath ETNs for which investors agree to treat such gain or loss as ordinary.”

ETNs are not Section 1256 contracts

- In the VXX ETN prospectus, the tax attorneys suggested reasons why the IRS might apply Section 1256 as “possible alternative” tax treatment. But, they did not imply investors should try to use Section 1256 treatment.
- Our firm's tax attorneys researched whether there is “substantial authority” for the position that 1256 applies to VXX and they concluded there is no substantial authority.
- Read our rationale in our blog post:
- Tax Treatment For Exchange Traded Notes (ETNs)
- <https://greentradertax.com/how-to-avoid-tax-reporting-trouble-with-exchange-traded-notes/>

Volatility ETN products

In order of volume <http://etfdb.com/etfdb-category/volatility/>

- iPath S&P 500 VIX ST Futures ETN (**VXX**)
- iPath S&P 500 VIX Mid-Term Futures ETN (**VXZ**)
- VelocityShares 1X Daily Inverse VSTOXX Futures ETN (**EXIV**)
- VelocityShares VIX Variable Long/Short ETN (**LSVX**)
- VelocityShares VIX Tail Risk ETN (**BSWN**)
- VelocityShares 1X Long VSTOXX Futures ETN (**EVIX**)
- iPath S&P 500 Dynamic VIX ETN (**XVZ**)
- VelocityShares Daily Long VIX Short-Term ETN (**VIIX**)
- Listed on securities exchanges: NYSE, Nasdaq or Bats.

OPTIONS ON ETNS

Tax treatment is uncertain.

Tax treatment for options on ETNs is uncertain

- The CBOE lists options on VXX (ETN).
- An IRS official told our tax attorney Roger D. Lorence: Any option listed on CBOE or other qualified board or exchange (QBE) whose reference is not a single symbol or a narrow-based index is a non-equity option in Section 1256.
- The equity option definition has two different prongs: single symbol and narrow-based index.
- Using this rationale, the IRS official told us the option on VXX (ETN) is a non-equity option in Section 1256.

DEPARTING FROM BROKER- ISSUED FORM 1099-B

Your broker may treat some volatility options as equity options, when it may be more likely, they are “non-equity options” with lower 60/40 tax rates in Section 1256.

Departing from 1099-Bs on tax returns

- When tax treatment is uncertain, or IRS guidance is lacking, brokers tend to use conservative tax treatment on 1099-B reporting, which is fair. That's the case with CBOE-listed volatility options on some VIX Indexes, volatility ETFs PTP, and ETNs.
- We noticed several brokers correctly treat CBOE-listed options on VIX Indexes as Section 1256 contracts. Other brokers treat them as equity options (securities).
- Several brokers treat CBOE-listed options on volatility ETF PTP, and ETNs as equity options, whereas we think they are likely non-equity options in Section 1256.

IRS Form 8275 Disclosure Statement

- I doubt brokers will correct 1099-Bs for this uncertain tax treatment, so consider departing from 1099-B on your tax return and explain it in tax return footnotes and perhaps a Form 8275.
- When a tax preparer departs from tax treatment on a broker-issued 1099-B, they should consider filing Form 8275 (Disclosure Statement).
- The IRS states: "Taxpayers and tax return preparers use this form (8275) to disclose items or positions that are not otherwise adequately disclosed on a tax return to avoid certain penalties."
- Departure from 1099-Bs may draw IRS attention.

Substantial authority position

- Our tax attorneys are working on establishing a "substantial authority" (SA) position to use the tax treatment mentioned in this presentation.
- SA means it is 33% likely to be correct and it's okay for a tax preparer to sign a tax return with protection against accuracy-related penalties.
- If you are interested in using Section 1256 tax treatment for CBOE-listed options on: VIX Indexes, volatility ETF PTP and ETNs (i.e. VXX), contact us for help at info@gnmtradertax.com.

CLOSING REMARKS, QUESTIONS & ANSWERS

Closing Remarks

- Questions & Answers
- Thank you for attending this Webinar or watching the recording at IB.
- Visit www.GreenTraderTax.com for additional information.
- Call us toll free at 888.558.5257 or 203.456.1537
- Chat with us.
- Email us your questions at info@greentradertax.com

888.558.5257 / 203.466.1537

Contact Us

Live Chat



SPECIAL CONTENT & INVITATIONS



ACCOUNT



LOGOUT



CART

green TraderTax
Because traders are our business.

Trader Tax Center

Learn tax treatments and strategies for traders

Professional Services

Expert advice and services from our CPA firm

About Us

Recognized as the leader in trader tax

GET EXPERT HELP / ADVICE

Trust the best CPAs and tax attorneys in the trader-tax niche.

[More >](#)

in 5 6 27

Search

Recent blogs [view all >](#)

Tax Reform Is Uncertain So Reconsider Your Investment Strategy [More](#)

By: Robert A. Green, CPA On: 08/31/17

Cryptocurrency Traders Risk IRS Trouble With Like-Kind Exchanges [More](#)

By: Robert A. Green, CPA On: 08/13/17

Traders Need Fair Tax Reform [More](#)

By: Robert A. Green, CPA On: 08/07/17

How To Report Bitcoin Cash And Avoid IRS Trouble [More](#)

Events & Recordings [view all >](#)

Tax Treatment For Volatility Products Including ETNs [More](#)

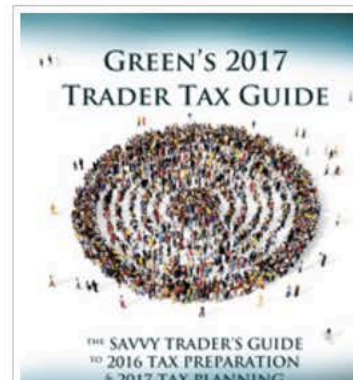
Sep 12, 2017
12:00 pm EST
60 minutes [Register >](#)

How To Trade Cryptocurrencies And Stay Out Of Trouble With The IRS And CFTC [More](#)

Sep 26, 2017
4:15 pm EST
60 minutes [Register >](#)

Aug 08, 2017 - How To Become Eligible For Trader Tax Status Benefits [More](#)

Trader Tax Guide [view all >](#)



- BLOG
- EVENTS
- TRADER TAX GUIDE
- FILE SHARING
- PURCHASE SERVICES