

# **Report about constructive sales**

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## **Firstly, what is the constructive sales?**

The Constructive Sale Rule, is a section of the Internal Revenue Code that expands the types of transactions that are considered to be sales and are subject to capital gains tax. According to this rule, transactions that effectively take an offsetting position to an already owned position are considered to be constructive sales. And Constructive sales include making short sales against similar or identical positions and entering into futures or forward contracts that call for the delivery of an already-held asset.

## **Secondly, what is the purpose of the constructive sales?**

The purpose of the constructive sale rule is to prevent investors from locking in investment gains without paying capital gains and to limit their ability to transfer gains from one tax period to another.

## **Third, Why the Constructive Sale Rule Was Established?**

Prior to this rule, there were rampant constructive sales, particularly by hedge funds, as a way to remove tax liabilities by stalling the realization of gains on sales. This was to avoid the higher tax rates on short-term capital gains, And With the Constructive Sale Rule in place, this practice was put to an end.

Fourthly and finally, let us take one example of Constructive Sales.

**Example -> Long Constructive Sale**

Event Date	Investment	Quantity	Event Type	Total Amount
01/03/2011	ABC	1.00	Buy	100
12/30/2011	ABC	-1.00	Short Sell	-125

**Activity :**

- The taxpayer buys a single share of stock ABC on January 3rd of 2011 for \$100.
- On December 30th, the taxpayer shorts one share of stock ABC at \$125.

**Result :**

- The taxpayer recognizes a short-term capital gain of \$25 achieved on December 30th due to a constructive sale created on that date.
- The cost basis adjustment is \$25, meaning the cost basis of the long share purchased on January 3rd is increased from \$100 to \$125 and the apparent tax date of this position is reset to December 30th.
- But this configuration also forms a straddle, so the day-counter for the holding period is suspended while the straddle is in place.