

Dealers in securities futures contracts. This ruling holds that Category 1 and Category 2 OneChicago LLC Market Makers that satisfy the Market Maker requirements described in the ruling and satisfy the section 1256 Dealer Qualification quotation requirements described in the ruling perform functions similar to the functions performed by options dealers (as defined in section 1256(g)(8)(A) of the Code) and that these OneChicago LLC Market Makers are therefore dealers

in securities futures contracts within the meaning of section 1256(g)(9)(B).

Rev. Rul. 2004-95

ISSUE

If a Category 1 or Category 2 OneChicago LLC (OneChicago) Market Maker satisfies the Market Maker requirements described below and satisfies the Section 1256 Dealer Qualification quotation requirements described below, is it a dealer in securities futures contracts (SFCs) within the meaning of § 1256(g)(9)(B) of the Internal Revenue Code?

FACTS

OneChicago has been designated by the Commodity Futures Trading Commission (CFTC) as a contract market that is permitted to list SFCs. As such, OneChicago is a “qualified board or exchange” within the meaning of § 1256(g)(7). OneChicago has a market maker program under which OneChicago members may qualify as OneChicago Market Makers eligible for the market maker exclusion provided in OneChicago’s customer margin rules. OneChicago Market Makers are obligated to provide liquidity for their specifically assigned SFC products that trade on OneChicago. For this purpose, an SFC product consists of contracts that may have varying maturities but that all relate to a particular underlying security or a particular narrow-based index of securities.

A Category 1 or Category 2 OneChicago Market Maker must meet all of the following requirements:

- (1) Be a member of OneChicago;
- (2) Be registered as a floor trader or floor broker with the CFTC or as a dealer with the Securities and Exchange Commission (SEC);
- (3) Maintain records sufficient to prove compliance with OneChicago Market Maker requirements and the related regulations and rules of the CFTC or SEC, as applicable, including, without limitation, trading account statements and other financial records sufficient to detail activity; and
- (4) Hold itself out as willing to buy and sell SFCs for its own account on a regular or continuous basis.

For a OneChicago Market Maker to fulfill the regular or continuous requirement in paragraph (4) above, it must satisfy the following criteria, as applicable, for each of its assigned SFC products:

Category 1 Market Maker— The member provides continuous two-sided quotations throughout the trading day for all delivery months of all assigned SFC products (where such assigned SFC products represent in the aggregate at least a meaningful proportion of the total trading volume on OneChicago), except during unusual market conditions as determined by OneChicago (such as a fast market in either an SFC product or a security underlying an SFC product), at which time the member must use its best efforts to quote continuously and competitively; and, when the member provides quotations, it quotes for a minimum of one SFC with a Maximum Bid/Ask Spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each SFC product; or

Category 2 Market Maker— The member responds to at least 75% of the requests for quotation (RFQs) for all delivery months of all assigned SFC products (where such assigned SFC products represent in the aggregate at least a meaningful proportion of the total trading volume on OneChicago), except during unusual market conditions as determined by OneChicago (such as a fast market in either an SFC product or a security underlying an SFC product), at which times the member must use its best efforts to quote competitively; and, when the member responds to RFQs, it quotes within five seconds for a minimum of one SFC with a Maximum Bid/Ask Spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each SFC product.

For purposes of the preceding requirements for Category 1 and Category 2 Market Makers, a “meaningful proportion of the total trading volume on OneChicago” means a minimum of 20% of the trading volume of SFCs traded on OneChicago during the calendar quarter.

Any OneChicago Market Maker that fails to comply with the OneChicago rules, CFTC rules, or SEC rules, as applicable, is subject to disciplinary action in accordance with OneChicago rules.

Section 1256 Dealer Qualification. Category 1 and Category 2 Market Makers seeking to qualify as a § 1256(g)(9)(B) dealer under OneChicago’s market maker program must agree to meet minimum quotation size requirements for all of their assigned SFC products that are specified for purposes of the market maker exclusion provided in OneChicago’s margin rules. Category 1 and Category 2 Market Makers must provide continuous two-sided quotations or respond to requests for quotations in accordance with the applicable obligations set forth above by quoting:

(a) ten contracts for each product not covered by (b) or (c);

(b) five contracts for each product specified by the member to the extent such quotations are provided for delivery months other than the next two delivery months then trading; and

(c) one contract for any single stock futures contract where the average market price for the underlying stock was \$100 or higher for the preceding calendar month or for any narrow-based stock index futures contract, as defined by § 1a(25) of the Commodity Exchange Act.

LAW

Section 1256(g)(8)(A) defines the term “options dealer” to mean any person registered with an appropriate national securities exchange as a market maker or specialist in listed options. Section 1256(g)(9)(B) provides that a person shall be treated as a dealer in SFCs or options on such contracts if the Secretary determines that such person performs, with respect to such contracts or options, as the case may be, functions similar to the functions performed by an options dealer. Section 1256(g)(9)(B) further provides that such determination shall be made to the extent appropriate to carry out the purposes of that section.

The legislative history for § 1256(g)(9) states the following with respect to the determination process:

The determination of who is a dealer in securities futures contracts is to be made in a manner that is appropriate to carry out the purposes of the provision, which generally is to provide comparable tax treatment between dealers in securities futures contracts, on the one hand, and dealers in equity options,

on the other. Although traders in securities futures contracts (and options on such contracts) may not have the same market-making obligations as market makers or specialists in equity options, many traders are expected to perform analogous functions to such market makers or specialists by providing market liquidity for securities futures contracts (and options) even in the absence of a legal obligation to do so. Accordingly, the absence of market-making obligations is not inconsistent with a determination that a class of traders are dealers in securities futures contracts (and options), if the relevant factors, including providing market liquidity for such contracts (and options), indicate that the market functions of the traders is comparable to that of equity options dealers.

H.R. Conf. Rep. No. 106-1033, at 1036 (2000).

HOLDING

It is determined that Category 1 and Category 2 OneChicago Market Makers that satisfy the Market Maker requirements described above and satisfy the Section 1256 Dealer Qualification quotation requirements described above perform functions similar to the functions performed by options dealers (as defined in § 1256(g)(8)(A)) and that these OneChicago Market Makers are therefore dealers in SFCs within the meaning of § 1256(g)(9)(B). This determination will cease to apply in the event of material changes in the OneChicago Market Maker program affecting the Category 1 or Category 2 Market Makers described above. See § 601.601(d)(2)(v) of the Income Tax Regulations.

EFFECTIVE DATE

The effective date of this ruling is the date of publication in the Internal Revenue Bulletin. Because this ruling is prospective only, the holding applies to SFCs that are entered into by a dealer in SFCs on or after the effective date of this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is K. Scott Brown of the Office of Associate Chief Counsel (Financial Institu-

tions & Products). For further information regarding this revenue ruling, contact K. Scott Brown at (202) 622-3920 (not a toll-free call).
