Proposed Regulations Would Classify Basket Contract Transactions as Listed Transactions

By Danielle Marr, Sam Lichtman, Don Shiman | August 2, 2024

RELATED PRACTICES Tax

On July 11, 2024, the U.S. Department of the Treasury and IRS issued proposed regulations (the "**Proposed Regulations**") that would identify certain basket contract transactions as listed transactions – a type of reportable transaction.

A "basket contract" is a type of structured financial transaction involving an option, notional principal contract, forward contract or other derivative contract through which a taxpayer may be able to defer tax recognition and convert investments that would normally generate ordinary income into long-term capital gain.

In a typical basket contract, a taxpayer enters into a contract with a counterparty to receive a return based on the performance of a "basket" of referenced assets, which may include hedge fund interests, securities, commodities, foreign currency or similar property. The taxpayer, or its designee, has discretion to determine the assets in the "basket," change the trading algorithm, or request that the contract counterparty change the trading algorithm. The basket contract has a stated term of more than one year or overlaps two taxable years, and the amount that the taxpayer receives upon settlement of the contract is based on performance of the assets in the reference "basket."

The IRS previously issued two notices in 2015 that were intended to rein in basket contract transactions. Notice 2015-73 identified "basket option contracts" as listed transactions and Notice 2015-74 identified the broader category of "basket contracts" as transactions of interest.

A "listed transaction" is a transaction identified by the IRS in published guidance as a tax avoidance transaction (or any substantially similar transaction). Listed transactions are treated as "reportable transactions," and taxpayers must use IRS Form 8886, *Reportable Transaction Disclosure Statement*, to disclose information related to any such transaction in which they participate. Similarly, material advisors must use IRS Form 8918, *Material Advisor Disclosure Statement*, to disclose information related to any listed transaction for which they act as a material advisor to a taxpayer. Penalties may apply for failure to comply.

The Proposed Regulations would classify certain basket contract transactions as listed transactions, effective as of the date the Proposed Regulations are finalized. The Proposed Regulations note concerns that taxpayers may be using basket contracts to inappropriately defer income recognition or convert ordinary income or short-term capital gain into long-term capital gain. The Proposed Regulations also note concerns that taxpayers may be mischaracterizing basket contract transactions as options or other derivatives in an effort to avoid application of Internal Revenue Code Section 1260 (with respect to constructive ownership transactions), Section 1291 (with respect to passive foreign investment companies) or both.

The Proposed Regulations include the transactions described in both 2015 notices as listed transactions (not merely transactions of interest). Accordingly, under current law, only "basket

© 2026 Haynes and Boone, LLP

option contracts” continue to be classified as listed transactions. If and when the Proposed Regulations are finalized, the broader category of “basket contracts” described in the Proposed Regulations will be treated as listed transactions and subject to the disclosure and recordkeeping requirements applicable to reportable transactions.

© 2026 Haynes and Boone, LLP