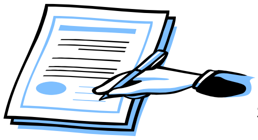
Son of Boss Transaction in a Nutshell



Contract One (Selling a Call Option)

Taxpayer enters into a contract giving a buyer the right to buy 1,000 shares of X stock for $150/share and receives $20,000 for the contract.

Taxpayer

STEP 1

Contract One: amount paid: $21,000
Contract Two: amount received: $20,000
Net cash outlay = 1,000

Contract Two (Purchasing a Call Option)

Taxpayer purchases a contract giving him the right to buy 1,000 shares of X stock for $150/share and pays $21,000 for the contract.

STEP 2

$10

Partner 2 contributes $10.00

Taxpayer Transfers Contracts One and Two to a Partnership in return for a Partnership Interest. The actual economic value of the partnership is nominally $1,010 because of the offsetting contracts, plus $10.00.

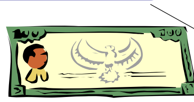
Contract One

Contract Two

Contract One

Contract Two

Note: Taxpayer claims a basis of $21,000 in Contract Two and a corresponding basis in his Partnership interest. Taxpayer does not reduce his Partnership basis by the $20,000 received for Contract One.



Partnership Interest

Taxpayer

STEP 3

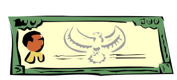
Partnership sells both contracts for a net gain of $400, and distributes $390 to Taxpayer. [Partner 2 receives $10.00.]

Taxpayer

STEP 4

Taxpayer claims a $21,000 basis in Contract Two and a corresponding basis in his Partnership Interest; therefore, taxpayer reports a “loss” of $20,610.

$20,610 Loss



Partnership Interest

Partnership Interest:
Amount Realized: $390
Adjusted basis: $21,000
Loss on Sale: $20,610

How much did the Partnership interest really cost the taxpayer?

A. $610

B. $20,610

Apart from the tax angle, why would anyone enter into this transaction?