Information Circular IC09-043

Date: May 12, 2009

To: CBOE Membership

From: Office of the Chairman

Re: Potential Change to "60/40 Tax Rule"

Yesterday, as the Obama Administration released its proposed Budget for 2010, we learned that the proposal includes plans to radically change existing tax law treatment for futures traders and options market participants, particularly options market makers. The proposal calls for the repeal of the long-standing "60/40 Rule," which allows market makers to pay a blend of capital gains and ordinary tax rates on their income. Under that blended rate, 60 cents of each dollar earned by an options dealer is taxed at the 15-percent capital gains rate while the remaining 40 cents is taxable at ordinary rates as high as 35 percent. Combined, the effective tax rate is 23 percent. The top rate on ordinary income is currently 35 percent, but the 2010 budget proposal calls for that rate to increase to 39.6 percent in 2011.

The "60/40 Rule" was enacted as compensation for tax consequences posed by the imposition of a mark-to-market tax regime: The 60/40 blended rate formula was enacted 25 years ago to compensate market makers who were subject to mark-to-market requirements and, thus, were required to include as income any gains and losses on options at year's end, *regardless of whether gains had actually been realized.* The 2010 budget proposal would eliminate the "60/40" treatment, but retain the mark-to-market detriment.

Although intended as a means to generate tax revenues, the proposed repeal of the "60/40 Rule" would adversely affect the entire marketplace, including the investing public. It would abrogate, to the detriment of both the financial markets and individual market participants, closely studied tax policy that has been in effect – and worked well – for over 25 years. As noted, 60/40 tax treatment was enacted, not as an arbitrary "tax break," but as part of a delicate tax formula designed to preserve the vital role of market maker. CBOE believes that elimination of this tax provision will upset that balance and lead to unintended but harmful consequences.

The increase in the market maker's cost of doing business will ultimately be passed on to the end user. Changes in the tax code will change the cost of doing business. The imposition of unduly onerous tax requirements will mean that market makers will no longer be able to operate on razor-thin margins, and the increased cost of doing business will be passed along to the end user in the form of wider spreads.

Wider spreads and increased transaction costs will result in a less liquid marketplace. The investing public is well served by robust and liquid exchange markets. While the current, widespread economic crisis exposed dangerous cracks in our nation's regulatory structure and banking and finance industries, it also highlighted the reliability of regulated exchanges. Tested by unprecedented challenges, regulated exchanges performed extremely well throughout the crisis, continuing to provide transparent, liquid markets and to disseminate prices without interruption.

Now, as our markets and customers struggle to recover, is not the time to tamper with what has worked. We urge the Obama Administration not to disturb the delicate balance that has made regulated exchanges one of the few financial arenas that can be relied upon to function effectively, even in the midst of extreme market turmoil.

We will keep you apprised of new developments in this important matter.