

\$18.75 (i.e., the total carrying charges (\$50), divided by the total number of payments (8), multiplied by the number of payments made in 1968 (3)). Since the amount to be treated as interest in 1968 (\$10.50) does not exceed the carrying charges attributable to 1968 (\$18.75), the limitation set forth in paragraph (c) of this section is not applicable.

(ii) The result in this example would be the same even if the X University assigned the agreement to a bank or other financial institution and C made his payments directly to the bank or other financial institution.

Example 5. On September 15, 1968, D registered at Y University for the 1968-69 academic year. The tuition for such year was \$1,500. In order to pay his tuition, D borrowed \$1,500 from the M Corporation, a lending institution, and remitted that sum to the Y University. The loan agreement between M Corporation and D provided that D was to repay the loan, plus a service charge, in 10 equal monthly installments, on the first day of each month commencing with October 1968. The service charge consisted of interest and the cost of credit life insurance on D's life. Since section 163(b) and this section do not apply to a contract for the loan of money, D is not entitled to compute his interest deduction with respect to his loan from M Corporation under such sections. D may deduct that portion of each installment payment which constitutes interest (as distinguished from payments of principal and the charge for credit life insurance) under section 163(a) and § 1.163-1, provided that the amount of such interest can be ascertained.

(e) *Effective date.* Except in the case of payments made under a contract for educational services, the rule provided in section 163(b) and this section applies to payments made during taxable years beginning after December 31, 1953, and ending after August 16, 1954, regardless of when the contract of sale was made. In the case of payments made under a contract for educational services, the rule provided in section 163(b) and this section applies to payments made during taxable years beginning after December 31, 1963, regardless of when the contract for educational services was made.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6991, 34 FR 742, Jan. 17, 1969]

§ 1.163-3 Deduction for discount on bond issued on or before May 27, 1969.

(a) *Discount upon issuance.* (1) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or

amortized over the life of the bonds. For purposes of this section, the amortizable bond discount equals the excess of the amount payable at maturity (or, in the case of a callable bond, at the earlier call date) over the issue price of the bond (as defined in paragraph (b)(2) of § 1.1232-3).

(2) In the case of a bond issued by a corporation after December 31, 1954, as part of an investment unit consisting of an obligation and an option, the issue price of the bond is determined by allocating the amount received for the investment unit to the individual elements of the unit in the manner set forth in subdivision (ii)(a) of § 1.1232-3(b)(2). Discount with respect to bonds issued by a corporation as part of investment units consisting of obligations and options after December 31, 1954, and before Dec. 24, 1968—

(i) Increased by any amount treated as bond premium which has been included in gross income with respect to such bonds prior to Dec. 24, 1968, or

(ii) Decreased by any amount which has been deducted by the issuer as discount attributable to such bonds prior to Dec. 24, 1968, and

(iii) Decreased by any amount which has been deducted by the issuer prior to Dec. 24, 1968 upon the exercise or sale by investors of options issued in investment units with such bonds,

should be amortized, starting with the first taxable year ending on or after Dec. 24, 1968 over the remaining life of such bonds.

(b) *Examples.* The rules in paragraph (a) of this section are illustrated by the following examples:

Example 1. M Corporation, on January 1, 1960, the beginning of its taxable year issued for \$95,000, 3 percent bonds, maturing 10 years from the date of issue, with a stated redemption price at maturity of \$100,000. M Corporation should treat \$5,000 (\$100,000-\$95,000) as the total amount to be amortized over the life of the bonds.

Example 2. Assume the same facts as example (1), except that the bonds are convertible into common stock of M Corporation. Since the issue price of the bonds includes any amount attributable to the conversion privilege, the result is the same as in example (1).

Example 3. Assume the same facts as example (1), except that the bonds are issued as part of an investment unit consisting of an obligation and an option. Assume further

that the issue price of the bonds as determined under the rules of allocation set forth in subdivision (ii)(a) of § 1.1232-3(b)(2) is \$94,000. Accordingly, M Corporation should treat \$6,000 (\$100,000-\$94,000) as the total amount to be amortized over the life of the bonds.

Example 4. Assume in example (3), that prior to Dec. 24, 1968, M Corporation had only treated \$5,000 as the bond discount to be amortized and deducted only \$4,000 of this amount. Starting with the first taxable year ending on or after Dec. 24, 1968, M Corporation should amortize \$2,000 (\$6,000 discount, less \$4,000 previously deducted) over the remaining life of the bonds.

Example 5. N Corporation, on January 1, 1956, for a consideration of \$102,000, issued 20-year bonds in the face amount of \$100,000, together with options to purchase stock of N Corporation. The issue price of the bonds as determined under the rules of allocation set forth in subdivision (ii)(a) of § 1.1232-3(b)(2) is \$99,000. Until Dec. 24, 1968, N Corporation has treated as bond premium, \$2,000, representing the excess of the consideration received for the bond-option investment units over the maturity value of the bonds, and has accordingly prorated and included in income \$1,200 of such amount. Starting with the first taxable year beginning on or after Dec. 24, 1968, N Corporation may amortize as a deduction over the remaining life of the bonds the amount of \$2,200 (\$1,000 discount, plus \$1,200 previously included in income).

Example 6. O Corporation, on January 1, 1956, for a consideration of \$100,000, issued 20-year bonds with a \$100,000 face value, together with options to purchase stock of O Corporation, which could be exercised at any time up to 5 years from the date of issue. The issue price of the bonds as determined under the rules of allocation set forth in subdivision (ii)(a) of § 1.1232-3(b)(2) is \$98,000. O Corporation, upon the exercise of the options prior to Dec. 24, 1968, had deducted from income their fair market value at the time of exercise, which is assumed for purposes of this example to have been \$3,000. Even though the bonds are considered to have been issued at a discount under paragraph (a)(1) of this section, O Corporation would have no deduction over the remaining life of the bonds, inasmuch as O Corporation, in computing the amount of such deduction, is required under paragraph (a)(2)(iii) of this section to reduce the amount which would otherwise be treated as bond discount, \$2,000 (\$100,000-\$98,000), by the amount deducted from income upon the exercise of the options, in this case, \$3,000.

(c) *Deduction upon repurchase.* (1) Except as provided in subparagraphs (2) and (3) of this paragraph, if bonds are issued by a corporation and are subsequently repurchased by the corporation

at a price in excess of the issue price plus any amount of discount deducted prior to repurchase, or (in the case of bonds issued subsequent to Feb. 28, 1913) minus any amount of premium returned as income prior to repurchase, the excess of the purchase price over the issue price adjusted for amortized premium or discount is a deductible expense for the taxable year.

(2) In the case of a convertible bond (except a bond which the corporation, before Sept. 5, 1968, has obligated itself to repurchase at a specified price), the deduction allowable under subparagraph (1) of this paragraph may not exceed an amount equal to 1 year's interest at the rate specified in the bond, except to the extent that the corporation can demonstrate to the satisfaction of the Commissioner or his delegate that an amount in excess of 1 year's interest does not include any amount attributable to the conversion feature.

(3) No deduction shall be allowed under subparagraph (1) of this paragraph to the extent a deduction is disallowed under subparagraph (2) of this paragraph or to the extent a deduction is disallowed by section 249 (relating to limitation on deduction of bond premium on repurchase of convertible obligation) and the regulations thereunder. See paragraph (f) of § 1.249-1 for effective date limitation on section 249.

(d) *Definition.* For purposes of this section, a debenture, note, certificate or other evidence of indebtedness, issued by a corporation and bearing interest shall be given the same treatment as a bond.

(e) *Effective date.* The provisions of this section shall not apply in respect of a bond issued after May 27, 1969, unless issued pursuant to a written commitment which was binding on that date and at all times thereafter.

[T.D. 6984, 33 FR 19175, Dec. 24, 1968, as amended by T.D. 7154, 36 FR 24996, Dec. 28, 1971; T.D. 7259, 38 FR 4253, Feb. 12, 1973]

§ 1.163-4 Deduction for original issue discount on certain obligations issued after May 27, 1969.

(a) *In general.* (1) If an obligation is issued by a corporation with original issue discount, the amount of such discount is deductible as interest and