counterparty as a deemed exchange of the original contract for a modified contract that differs materially either in kind or in extent if—

(1) Both the party transferring or assigning its rights and obligations under the derivative contract and the party to which the rights and obligations are transferred or assigned are either a dealer or a clearinghouse;

(2) The terms of the derivative contract permit the transfer or assignment of the contract, whether or not the consent of the nonassigning counterparty is required for the transfer or assignment to be effective; and

(3) The terms of the derivative contract are not otherwise modified in a manner that results in a taxable exchange under section 1001.

(b) *Definitions*—(1) *Dealer*. For purposes of this section, a *dealer* is a taxpayer who meets the definition of a dealer in securities in section 475(c)(1) or is a dealer in commodities derivative contracts.

(2) *Clearinghouse*. For purposes of this section, a *clearinghouse* is a derivatives clearing organization (as such term is defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a))) that is registered, or exempt from registration, under each respective Act.

(3) *Derivative contract*. For purposes of this section, a *derivative contract* is a contract described in—

(i) Section 475(c)(2)(D), 475(c)(2)(E), or 475(c)(2)(F) without regard to the last sentence of section 475(c)(2) referencing section 1256;

(ii) Section 475(e)(2)(B), 475(e)(2)(C), or 475(e)(2)(D); or

(iii) Section 1.446–3(c)(1).

(c) *Consideration for the assignment*. Any payment between a party transferring or assigning its rights and obligations under the contract and the party to which the rights and obligations are transferred or assigned pursuant to a transfer or assignment described in paragraph (a) of this section will not affect the treatment of the nonassigning counterparty for purposes of this section. A payment described in the preceding sentence made or received to transfer or assign rights and obligations under a notional principal contract (as defined in §1.446–3(c)(1)) is not subject to §1.446–3(g)(4).

(d) *Effective/applicability date*. This section applies to transfers or assignments of derivative contracts on or after July 22, 2011.

[T.D. 9639, 78 FR 66640, Nov. 6, 2013]

§ 1.1001–5 European Monetary Union (conversion to the euro).

(a) *Conversion of currencies*. For purposes of §1.1001–1(a), the conversion to the euro of legacy currencies (as defined in §1.985–8(a)(1)) is not the exchange of property for other property differing materially in kind or extent.

(b) *Effect of currency conversion on other rights and obligations*. For purposes of §1.1001–1(a), if, solely as the result of the conversion of legacy currencies to the euro, rights or obligations denominated in a legacy currency become rights or obligations denominated in the euro, that event is not the exchange of property for other property differing materially in kind or extent. Thus, for example, when a debt instrument that requires payments of amounts denominated in a legacy currency becomes a debt instrument requiring payments of euros, that alteration is not a modification within the meaning of §1.1001–3(c).

(c) *Effective date*. This section applies to tax years ending after July 29, 1998.

[T.D. 8927, 66 FR 2218, Jan. 11, 2001]

§ 1.1001–6 Transition from certain interbank offered rates.

(a) *In general*. This section provides rules relating to the modification of the terms of a contract as part of the transition away from the London Interbank Offered Rate and certain other interbank offered rates. In general, paragraphs (b) through (g) of this section provide the operative rules for a covered modification. Paragraph (h) of this section defines certain terms that are used in these operative rules, such as *covered modification*, *qualified rate*, *discontinued IBOR*, *associated modification*, and *qualified one-time payment*. Paragraph (j) of this section describes certain modifications that are not covered modifications and provides examples that illustrate the operation of the rules in paragraph (j) of this section. For rules regarding original issue discount on certain debt instruments that provide for a rate referencing a discontinued IBOR, see §1.1275–2(m). For rules regarding certain interests in a REMIC that provide for a rate referencing a discontinued IBOR, see §1.860G–1(e).

(b) *Treatment under section 1001*—(1) *Covered modifications.* A covered modification of a contract is not treated as the exchange of property for other property differing materially in kind or in extent for purposes of §1.1001–1(a). For example, if the terms of a debt instrument that pays interest at a rate referencing the U.S.-dollar London Interbank Offered Rate (USD LIBOR) are modified to provide that the debt instrument pays interest at a qualified rate referencing the Secured Overnight Financing Rate published by the Federal Reserve Bank of New York (SOFR) and the modification is not described in paragraph (j) of this section, the modification is not treated as the exchange of property for other property differing materially in kind or in extent for purposes of §1.1001–1(a).

(2) *Contemporaneous noncovered modifications.* If a covered modification is made at the same time as a noncovered modification, §1.1001–1(a) or §1.1001–3, as appropriate, applies to determine whether the noncovered modification results in the exchange of property for other property differing materially in kind or in extent. In applying §1.1001–1(a) or §1.1001–3 for this purpose, the covered modification is treated as part of the terms of the contract prior to the noncovered modification. For example, if the parties to a debt instrument modify the interest rate in a manner that is a covered modification and contemporaneously extend the final maturity date of the debt instrument, which is a noncovered modification, only the extension of the final maturity date is analyzed under §1.1001–3 and, for purposes of that analysis, the modified interest rate is treated as a term of the instrument prior to the extension of the final maturity date.

(c) *Effect of a covered modification on integrated transactions and hedging transactions*—(1) *In general.* Except as otherwise provided in paragraph (c)(2) of this section, the rules in paragraphs (c)(1)(i) through (iv) of this section determine the effect of a covered modification on an integrated transaction under §1.1275–6, a qualified hedging transaction under §1.988–5(a), a hedging transaction under §1.446–4, or a qualified hedging transaction under §1.148–4(h).

(i) A covered modification of one or more contracts that are part of an integrated transaction under §1.1275–6 is treated as not legging out of the integrated transaction, provided that, no later than the end of the 90-day period beginning on the date of the first covered modification of any such contract, the financial instrument that results from any such covered modifications satisfies the requirements to be a §1.1275–6 hedge (as defined in §1.1275–6(b)(2)) with respect to the qualifying debt instrument that results from any such covered modification. If a taxpayer enters into a financial instrument intended to mitigate the economic effect of a temporary mismatch of the legs of the integrated transaction during that 90-day period (a *§1.1275–6 interim hedge*), the integration of the §1.1275–6 interim hedge with the other components of the integrated transaction during the 90-day period is treated as not legging into a new integrated transaction and the termination of the §1.1275–6 interim hedge before the end of the 90-day period is treated as not legging out of the existing integrated transaction.

(ii) A covered modification of one or more contracts that are part of a qualified hedging transaction under §1.988–5(a) is treated as not legging out of the qualified hedging transaction, provided that, no later than the end of the 90-day period beginning on the date of the first covered modification of any such contract, the financial instrument or series or combination of financial instruments that results from any such covered modifications satisfies the requirements to be a §1.988–5(a) hedge (as defined in §1.988–5(a)(4)) with respect to the qualifying debt instrument that results from any such covered modification. If a taxpayer enters into a financial instrument intended to mitigate the economic effect of a temporary mismatch of the legs of the qualified hedging transaction during that 90-day period (a *§1.988–5(a) interim hedge*), the integration of the §1.988–5(a) interim hedge with the other components of the qualified hedging transaction during the 90-day period is treated as not legging into a new qualified hedging transaction and the termination of the §1.988–5(a) interim hedge before the end of the 90-day period is treated as not legging out of the existing qualified hedging transaction.

(iii) A covered modification of one leg of a transaction subject to the hedge accounting rules in §1.446–4 is not treated as a disposition or termination (within the meaning of §1.446–4(e)(6)) of either leg of the transaction.

(iv) A covered modification of a qualified hedge or of the tax-advantaged bonds with which the qualified hedge is integrated under §1.148–4(h)(1) is treated as not terminating the qualified hedge under §1.148–4(h)(3)(iv)(B), provided that, no later than the end of the 90-day period beginning on the date of the first covered modification of either the qualified hedge or the hedged bonds, the qualified hedge that results from any such covered modification satisfies the requirements to be a qualified hedge (determined by applying the special rules for certain modifications of qualified hedges under §1.148–4(h)(3)(iv)(C)) with respect to the hedged bonds that result from any such covered modification. Solely for purposes of determining whether the qualified hedge that results from a covered modification satisfies the requirements to be a qualified hedge with respect to the hedged bonds that result from any such covered modification in the preceding sentence, a qualified one-time payment with respect to the hedge or the hedged bonds (or both) is allocated in a manner consistent with the allocation of a termination payment for a variable yield issue under §1.148–4(h)(3)(iv)(H) and treated as a series of periodic payments. This paragraph (c)(1)(iv) does not apply if, prior to any covered modifications, the qualified hedge and the tax-advantaged bond are integrated under §1.148–4(h)(4).

(2) *Fallback rates.* If a covered modification of a contract that is part of an integrated transaction under §1.1275–6 is described in paragraph (h)(1)(ii) or (iii) of this section, that covered modification is treated as not legging out of the integrated transaction. If a covered modification of a contract that is part of a qualified hedging transaction under §1.988–5(a) is described in paragraph (h)(1)(ii) or (iii) of this section, that covered modification is treated as not legging out of the qualified hedging transaction. If a covered modification of a qualified hedge or of the tax-advantaged bonds with which the qualified hedge is integrated under §1.148–4(h) is described in paragraph (h)(1)(ii) or (iii) of this section, that covered modification is treated as not terminating the qualified hedge under §1.148–4(h)(3)(iv)(B).

(d) *Coordination with provision for existing obligations under chapter 4.* A modification of a contract is not a material modification of that contract for purposes of §1.1471–2(b)(2)(iv) to the extent the modification is a covered modification. See paragraph (b)(2) of this section for rules that apply for purposes of §1.1471–2(b)(2)(iv) when a modification to a contract includes both a covered modification and a contemporaneous noncovered modification.

(e) *Coordination with fast-pay stock rules.* A covered modification of stock is not a significant modification in the terms of the stock or the related agreements or a significant change in the relevant facts and circumstances for purposes of §1.7701(l)–3(b)(2)(ii). If a covered modification is made at the same time as, or as part of a plan that includes, a noncovered modification and the noncovered modification is a significant modification in the terms of the stock or the related agreements or a significant change in the relevant facts and circumstances, then §1.7701(l)–3(b)(2)(ii) applies to determine whether the stock is fast-pay stock, taking into account all the facts and circumstances (including both the covered and noncovered modification).

(f) *Coordination with rules for investment trusts.* A covered modification of a contract held by an investment trust does not manifest a power to vary the investment of the certificate holders for purposes of §301.7701–4(c)(1) of this chapter. Further, a covered modification of an ownership interest in an investment trust does not manifest a power to vary the investment of the certificate holder for purposes of §301.7701–4(c)(1) of this chapter.

(g) [Reserved]

(h) *Definitions*—(1) *Covered modification*. A *covered modification* is a modification or portion of a modification of the terms of a contract that is described in one or more of paragraphs (h)(1)(i) through (iii) of this section and that is not described in any of paragraphs (j)(1) through (5) of this section. Any modification of the terms of a contract described in section 4.02 of Rev. Proc. 2020–44, 2020–45 I.R.B. 991, or described in other guidance published in the Internal Revenue Bulletin that supplements the list of modifications described in section 4.02 of Rev. Proc. 2020–44 or the definitions on which that section relies (see §601.601(d)(2)(ii)(a) of this chapter) is treated as a covered modification. For purposes of this section, a modification of the terms of a contract includes any modification of the terms of the contract, regardless of the form of the modification (for example, a modification may be an exchange of one contract for another, an amendment to the existing contract, or a modification accomplished indirectly through one or more transactions with third parties) and regardless of whether the modification is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise. For purposes of this section, a contract includes but is not limited to a debt instrument, a derivative contract, stock, an insurance contract, and a lease agreement.

(i) The terms of the contract are modified to replace an operative rate that references a discontinued IBOR with a qualified rate, to add an obligation for one party to make a qualified one-time payment (if any), and to make associated modifications (if any).

(ii) The terms of the contract are modified to include a qualified rate as a fallback to an operative rate that references a discontinued IBOR and to make associated modifications (if any).

(iii) The terms of the contract are modified to replace a fallback rate that references a discontinued IBOR with a qualified rate and to make associated modifications (if any).

(2) *Noncovered modification*. A *noncovered modification* is any modification or portion of a modification of the terms of a contract that is not a covered modification.

(3) *Qualified rate*—(i) *In general*. A *qualified rate* is any of the rates described in paragraph (h)(3)(ii) of this section, provided that the interest rate benchmark to which the rate refers and the discontinued IBOR identified in paragraph (h)(1)(i), (ii), or (iii) of this section are based on transactions conducted in the same currency or are otherwise reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds in the same currency. For purposes of paragraphs (h)(1)(ii) and (iii) of this section, a single qualified rate may be comprised of one or more fallback rates (for example, a waterfall of fallback rates). Paragraph (h)(3)(iii) of this section provides additional rules for determining whether one or more fallback rates constitute a qualified rate, and paragraph (h)(3)(iv) of this section provides examples illustrating the operation of those rules.

(ii) *Rates*. The following rates are described in this paragraph (h)(3)(ii):

(A) A qualified floating rate, as defined in §1.1275–5(b), but without regard to the limitations on multiples set forth in §1.1275–5(b) (examples of qualified floating rates generally include SOFR, the Sterling Overnight Index Average, the Tokyo Overnight Average Rate, the Swiss Average Rate Overnight, and the euro short-term rate administered by the European Central Bank);

(B) An alternative, substitute, or successor rate selected, endorsed, or recommended by the central bank, reserve bank, monetary authority, or similar institution (including any committee or working group thereof) as a replacement for a discontinued IBOR or its local currency equivalent in that jurisdiction;

(C) A rate selected, endorsed, or recommended by the Alternative Reference Rates Committee as a replacement for USD LIBOR, provided that the Federal Reserve Bank of New York is an ex officio member of the Alternative Reference Rates Committee at the time of the selection, endorsement, or recommendation;

(D) A rate that is determined by reference to a rate described in paragraph (h)(3)(ii)(A), (B), or (C) of this section, including a rate determined by adding or subtracting a specified number of basis points to or from the rate or by multiplying the rate by a specified number; and

(E) A rate identified for purposes of this section as a qualified rate in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(a) of this chapter).

(iii) *Rules for fallback rates*—(A) *Multiple fallback rates*. If the rate being tested as a qualified rate is comprised of more than one fallback rate, the rate is a qualified rate only if each individual fallback rate separately satisfies the requirements to be a qualified rate.

(B) *Indeterminable fallback rate*. Except as provided in paragraph (h)(3)(iii)(C) of this section, if it is not possible to determine at the time of the modification being tested as a covered modification whether a fallback rate satisfies the requirements set forth in the first sentence of paragraph (h)(3)(i) of this section (for example, the calculation agent will determine the fallback rate at the time that the fallback rate is triggered based on factors that are not guaranteed to produce a rate described in paragraph (h)(3)(ii) of this section), the fallback rate is treated as not satisfying the requirements to be a qualified rate.

(C) *Fallback rate is a remote contingency*. If the likelihood that any value will ever be determined under the contract by reference to a fallback rate is remote (determined at the time of the modification being tested as a covered modification), that fallback rate is treated as satisfying the requirements to be a qualified rate.

(iv) *Examples*. The following examples illustrate the application of the rules in paragraphs (h)(3)(i) through (iii) of this section to qualified rates comprised of one or more fallback rates.

(A) *Example 1: Addition of a single fallback rate*—(*1*) *Facts*. B is the issuer and L is the holder of a debt instrument that pays interest semiannually in U.S. dollars at a rate of six-month USD LIBOR and that contains no fallback provisions to address the pending discontinuation of six-month USD LIBOR. On July 1, 2022, B and L modify the debt instrument to add such fallback provisions (the *new fallbacks*). The new fallbacks provide that, upon the discontinuation of six-month USD LIBOR, six-month USD LIBOR will be replaced by a fallback rate equal to CME Group's forward-looking SOFR term rate of a six-month tenor (*six-month CME Term SOFR*) plus a fixed spread that will be determined at the time of six-month USD LIBOR's discontinuation. Six-month USD LIBOR will be discontinued on June 30, 2023.

(*2*) *Analysis*. The fallback rate is a qualified floating rate and is, therefore, described in paragraph (h)(3)(ii)(A) of this section. Moreover, because both six-month USD LIBOR and six-month CME Term SOFR are based on transactions conducted in U.S. dollars, the fallback rate satisfies the currency requirement in paragraph (h)(3)(i) of this section. As further provided in paragraph (h)(3)(i) of this section, B and L must also apply the rules in paragraph (h)(3)(iii)(A), (B), and (C) of this section to determine if the fallback rate is a qualified rate. Because the rate being tested as a qualified rate (*i.e.*, the fallback rate) is comprised of only one fallback rate, paragraph (h)(3)(iii)(A) of this section has no effect. As discussed elsewhere in this paragraph (h)(3)(iv)(A)(*2*), it is evident at the time of the fallback rate's addition that the fallback rate satisfies the requirements set forth in the first sentence of paragraph (h)(3)(i) of this section, so paragraph (h)(3)(iii)(B) of this section has no effect. Because it appears likely at the time of the modification that the fallback rate will be used to determine interest on the debt instrument, paragraph (h)(3)(iii)(C) of this section has no effect. In summary, the fallback rate is described in paragraph (h)(3)(ii)(A) of this section and satisfies the currency requirement in paragraph (h)(3)(i) of this section, and none of the rules in paragraph (h)(3)(iii) of this section affect the analysis. Therefore, the fallback rate is a qualified rate.

(B) *Example 2: Addition of a single indeterminable fallback rate*—(*1*) *Facts*. The facts are the same as in paragraph (h)(3)(iv)(A)(*1*) of this section (*Example 1*), except that the new fallbacks provide that, upon the discontinuation of six-month USD LIBOR, B will select a replacement for six-month USD LIBOR based on the industry standard at the time of selection.

(*2*) *Analysis*. As provided in paragraph (h)(3)(i) of this section, B and L must apply the rule in paragraph (h)(3)(iii)(B) of this section to determine whether the fallback rate is a qualified rate. Because it is not possible to determine at the time of the fallback rate's addition in 2022 whether the fallback rate (*i.e.*, the replacement rate that B will select in 2023) satisfies the requirements set forth in the first sentence of paragraph (h)(3)(i) of this section, the fallback rate is treated as not satisfying the requirements to be a qualified rate under paragraph (h)(3)(iii)(B) of this section. Therefore, the fallback rate is not a qualified rate.

(C) *Example 3: Addition of a fallback waterfall that is a qualified rate*—(*1*) *Facts*. The facts are the same as in paragraph (h)(3)(iv)(A)(*1*) of this section (*Example 1*), except that the new fallbacks provide for a fallback waterfall. The first tier of the fallback waterfall provides that, upon the discontinuation of six-month USD LIBOR, six-month USD LIBOR will be replaced by a fallback rate equal to six-month CME Term SOFR plus a fixed spread that will be determined at the time of six-month USD LIBOR's discontinuation. The second tier of the fallback waterfall provides that, upon the discontinuation of six-month CME Term SOFR, B will select a replacement for the fallback rate in the first tier of the fallback waterfall based on the industry standard at the time of selection. At the time of the fallback waterfall's addition, the likelihood that six-month CME Term SOFR will be discontinued is remote.

(*2*) *Analysis of the fallback waterfall*. As provided in paragraph (h)(3)(i) of this section, B and L must apply the rules in paragraphs (h)(3)(iii)(A), (B) and (C) of this section to determine whether the fallback waterfall is a qualified rate. Under paragraph (h)(3)(iii)(A) of this section, because the rate being tested as a qualified rate (*i.e.*, the fallback waterfall) is comprised of more than one fallback rate, the fallback waterfall is a qualified rate only if each individual fallback rate (*i.e.*, fallback rates in the first and second tiers of the fallback waterfall) separately satisfies the requirements to be a qualified rate. As concluded in paragraphs (h)(3)(iv)(C)(*3*) and (*4*) of this section, the fallback rates in the first and second tiers of the fallback waterfall separately satisfy the requirements to be a qualified rate. Therefore, the fallback waterfall is a qualified rate.

(*3*) *Analysis of the first tier of the fallback waterfall*. Because the fallback rate in the first tier of the fallback waterfall is the same as the fallback rate in paragraph (h)(3)(iv)(A)(*1*) of this section (*Example 1*), the analysis of the fallback rate in the first tier of the fallback waterfall is the same as the analysis of the fallback rate in paragraph (h)(3)(iv)(A)(*2*) of this section (*Example 1*). Accordingly, the fallback rate in the first tier of the fallback waterfall separately satisfies the requirements to be a qualified rate.

(*4*) *Analysis of the second tier of the fallback waterfall*. The fallback rate in the second tier of the fallback waterfall is the same as the fallback rate in paragraph (h)(3)(iv)(B)(*1*) of this section (*Example 2*). However, unlike the fallback rate in paragraph (h)(3)(iv)(B)(*1*) of this section (*Example 2*), the likelihood that the amount of interest on the debt instrument will ever be determined by reference to the fallback rate in the second tier of the fallback waterfall is remote. Accordingly, under paragraph (h)(3)(iii)(C) of this section, the fallback rate in the second tier of the fallback waterfall is treated as satisfying the requirements to be a qualified rate.

(D) *Example 4: Addition of a fallback waterfall that is not a qualified rate*—(*1*) *Facts*. The facts are the same as in paragraph (h)(3)(iv)(A)(*1*) of this section (*Example 1*), except that the new fallbacks provide for a fallback waterfall. The first tier of the fallback waterfall provides that, upon the discontinuation of six-month USD LIBOR, six-month USD LIBOR will be replaced by a stated fallback rate (*Fallback Rate X*). Fallback Rate X, which is equal to an interest rate benchmark (*Benchmark X*) plus a fixed spread, satisfies the requirements set forth in the first sentence of paragraph (h)(3)(i) of this section. The second tier of the fallback waterfall provides that, upon the discontinuation of Benchmark X, B will select a replacement for Fallback Rate X based on the industry standard at the time of selection. At the time of the fallback waterfall's addition, the likelihood that Benchmark X will be discontinued is not remote.

(*2*) *Analysis of the fallback waterfall.* As provided in paragraph (h)(3)(i) of this section, B and L must apply the rules in paragraphs (h)(3)(iii)(A), (B) and (C) of this section to determine whether the fallback waterfall is a qualified rate. Under paragraph (h)(3)(iii)(A) of this section, because the rate being tested as a qualified rate (*i.e.*, the fallback waterfall) is comprised of more than one fallback rate, the fallback waterfall is a qualified rate only if each individual fallback rate (*i.e.*, the fallback rates in the first and second tiers of the fallback waterfall) separately satisfies the requirements to be a qualified rate. As concluded in paragraph (h)(3)(iv)(D)(*3*) of this section, the fallback rate in the second tier of the fallback waterfall is treated as not satisfying the requirements to be a qualified rate. Therefore, the fallback waterfall is not a qualified rate.

(*3*) *Analysis of the second tier of the fallback waterfall.* As provided in paragraphs (h)(3)(i) and (h)(3)(iii)(A) of this section, B and L must apply the rules in paragraphs (h)(3)(iii)(B) and (C) of this section to determine whether the fallback rate in the second tier of the fallback waterfall is a qualified rate. Because the likelihood that Benchmark X will be discontinued is not remote, paragraph (h)(3)(iii)(C) of this section has no effect on the analysis of the fallback rate in the second tier of the fallback waterfall. Under paragraph (h)(3)(iii)(B) of this section, because it is not possible to determine at the time of the fallback waterfall's addition in 2022 whether the fallback rate in the second tier of the fallback waterfall (*i.e.*, the replacement rate that B will select in 2023) satisfies the requirements set forth in the first sentence of paragraph (h)(3)(i) of this section, the fallback rate in the second tier of the fallback waterfall is treated as not satisfying the requirements to be a qualified rate.

(4) *Discontinued IBOR.* A *discontinued IBOR* is any interbank offered rate described in paragraph (h)(4)(i) or (ii) of this section but only during the period beginning on the date of the announcement described in paragraph (h)(4)(i) or (ii) of this section and ending on the date that is one year after the date on which the administrator of the interbank offered rate ceases to provide the interbank offered rate.

(i) The administrator of the interbank offered rate announces that the administrator has ceased or will cease to provide the interbank offered rate permanently or indefinitely, and no successor administrator is expected as of the time of the announcement to continue to provide the interbank offered rate; or

(ii) The regulatory supervisor for the administrator of the interbank offered rate, the central bank for the currency of the interbank offered rate, an insolvency official with jurisdiction over the administrator for the interbank offered rate, a resolution authority with jurisdiction over the administrator for the interbank offered rate, a court, or an entity with similar insolvency or resolution authority over the administrator for the interbank offered rate announces that the administrator of the interbank offered rate has ceased or will cease to provide the interbank offered rate permanently or indefinitely, and no successor administrator is expected as of the time of the announcement to continue to provide the interbank offered rate.

(5) *Associated modification.* An *associated modification* is a modification of the technical, administrative, or operational terms of a contract that is reasonably necessary to adopt or to implement the modifications described in paragraph (h)(1)(i), (ii), or (iii) of this section other than associated modifications. An associated modification also includes an incidental cash payment intended to compensate a counterparty

for small valuation differences resulting from a modification of the administrative terms of a contract, such as the valuation differences resulting from a change in observation period. Examples of associated modifications include a change to the definition of interest period or a change to the timing and frequency of determining rates and making payments of interest (for example, delaying payment dates on a debt instrument by two days to allow sufficient time to compute and pay interest at a qualified rate computed in arrears).

(6) *Qualified one-time payment.* A *qualified one-time payment* is a single cash payment that is intended to compensate the other party or parties for all or part of the basis difference between the discontinued IBOR identified in paragraph (h)(1)(i), (ii), or (iii) of this section and the interest rate benchmark to which the qualified rate refers.

(i) [Reserved]

(j) *Modifications excluded from the definition of covered modification.* A modification or portion of a modification described in any of paragraphs (j)(1) through (5) of this section is excluded from the definition of covered modification in paragraph (h)(1) of this section and therefore is a noncovered modification.

(1) The terms of the contract are modified to change the amount or timing of contractual cash flows and that change is intended to induce one or more parties to perform any act necessary to consent to a modification to the contract described in paragraph (h)(1)(i), (ii), or (iii) of this section. See paragraph (j)(6)(iii) of this section (*Example 3*).

(2) The terms of the contract are modified to change the amount or timing of contractual cash flows and that change is intended to compensate one or more parties for a modification to the contract not described in paragraph (h)(1)(i), (ii), or (iii) of this section. See paragraph (j)(6)(v) of this section (*Example 5*).

(3) The terms of the contract are modified to change the amount or timing of contractual cash flows and that change is either a concession granted to a party to the contract because that party is experiencing financial difficulty or a concession secured by a party to the contract to account for the credit deterioration of another party to the contract. See paragraph (j)(6)(vi) of this section (*Example 6*).

(4) The terms of the contract are modified to change the amount or timing of contractual cash flows and that change is intended to compensate one or more parties for a change in rights or obligations that are not derived from the contract being modified. See paragraph (j)(6)(vii) of this section (*Example 7*). If each contract in a given portfolio of contracts has the same parties, those parties modify more than one contract in the portfolio (each such contract is a *modified portfolio contract*), and those modifications provide for a single, aggregate qualified one-time payment with respect to all modified portfolio contracts, then the portion of the qualified one-time payment allocable to any one modified portfolio contract is treated for purposes of this paragraph (j)(4) as not intended to compensate for a change in rights or obligations derived from any other modified portfolio contract.

(5) The terms of the contract are modified to change the amount or timing of contractual cash flows and the modification is identified for purposes of this paragraph (j)(5) in guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*a*) of this chapter) as having a principal purpose of achieving a result that is unreasonable in light of the purpose of this section.

(6) *Examples.* The following examples illustrate the operation of the rules in paragraphs (j)(1) through (4) of this section.

(i) *Example 1: Covered modification*—(A) *Facts.* B is the issuer and L is the holder of a debt instrument that pays interest semiannually at a rate of six-month USD LIBOR plus 100 basis points. On July 1, 2022, B and L modify the debt instrument to replace that original rate with CME Group's forward-looking SOFR term rate of a six-month tenor (*six-month CME Term SOFR*) plus an adjustment spread of 42.826 basis points plus 100 basis points (the whole modification is the *LIBOR* *replacement modification with basis adjustment spread*). B and L chose the adjustment spread of 42.826 basis points because that is the adjustment spread used or recommended by the International Swaps and Derivatives Association and the Alternative Reference Rates Committee for similar substitutions or replacements of six-month USD LIBOR with a tenor-adjusted variant of SOFR.

(B) *Analysis*. The parties have modified the terms of the debt instrument to replace a rate referencing a discontinued IBOR (*i.e.*, six-month USD LIBOR plus 100 basis points) with a qualified rate (*i.e.*, six-month CME Term SOFR plus 142.826 basis points). The LIBOR replacement modification with basis adjustment spread is described in paragraph (h)(1)(i) of this section and not described in any of paragraphs (j)(1) through (5) of this section. Therefore, the LIBOR replacement modification with basis adjustment spread is a covered modification of the debt instrument.

(ii) *Example 2: Covered modification with qualified one-time payment*—(A) *Facts*. The facts are the same as in paragraph (j)(6)(i)(A) of this section (*Example 1*), except that, instead of the LIBOR replacement modification with basis adjustment spread, B and L modify the debt instrument by replacing the original rate of six-month USD LIBOR plus 100 basis points with six-month CME Term SOFR plus 100 basis points and by obligating B to make a cash payment to L equal to the present value of the adjustment spread of 42.826 basis points with respect to the debt instrument (this payment is the *basis adjustment payment*, and the whole modification is the *LIBOR replacement modification with basis adjustment payment*).

(B) *Analysis*. The parties have modified the terms of the debt instrument to replace a rate referencing a discontinued IBOR (*i.e.*, six-month USD LIBOR plus 100 basis points) with a qualified rate (*i.e.*, six-month CME Term SOFR plus 100 basis points) and have added an obligation for B to make the basis adjustment payment, which is a single cash payment that is intended to compensate L for the basis difference between the discontinued IBOR identified in paragraph (h)(1)(i) of this section (*i.e.*, six-month USD LIBOR) and the interest rate benchmark to which the qualified rate refers (*i.e.*, six-month CME Term SOFR). Accordingly, the basis adjustment payment is a qualified one-time payment as defined in paragraph (h)(6) of this section, and the LIBOR replacement modification with basis adjustment payment is described in paragraph (h)(1)(i) of this section. Because it is described in paragraph (h)(1)(i) of this section and not described in any of paragraphs (j)(1) through (5) of this section, the LIBOR replacement modification with basis adjustment payment is a covered modification of the debt instrument.

(iii) *Example 3: Inducement spread*—(A) *Facts*. The facts are the same as in paragraph (j)(6)(i)(A) of this section (*Example 1*), except that the debt instrument is part of a widely held issue of debt with identical terms. Under the trust indenture applicable to the debt instrument, if B proposes a modification of the terms of the debt and all holders of the debt consent to that modification, the terms of the debt are modified as B proposed. In accordance with the trust indenture, B proposes the LIBOR replacement modification with basis adjustment spread on January 1, 2022. To induce holders such as L to perform the acts necessary to consent to the LIBOR replacement modification with basis adjustment spread, B also proposes to increase the interest rate paid to each consenting holder by an additional spread of 10 basis points (the *inducement spread*). All holders, including L, consent to B's proposed modifications by June 1, 2022. On July 1, 2022, the debt instrument is modified to implement the LIBOR replacement modification with basis adjustment spread and to increase the interest rate by the inducement spread. Once all modifications are effective, the debt instrument pays interest at a rate of six-month CME Term SOFR plus 152.826 basis points.

(B) *Analysis*. As concluded in paragraph (j)(6)(i)(B) of this section (*Example 1*), the portion of these modifications that implements the LIBOR replacement modification with basis adjustment spread is a covered modification of L's debt instrument. However, the portion of these modifications that increases the interest rate by the inducement spread changes the amount of cash flows on L's debt instrument, and that change is intended to induce L to perform the acts necessary to consent to a modification to the debt instrument described in paragraph (h)(1)(i) of this section (*i.e.*, the LIBOR replacement modification with basis adjustment spread). Therefore, the portion of the modification that increases the interest rate by the inducement spread is described in paragraph (j)(1) of this section and, consequently, is a noncovered modification of L's debt instrument. See paragraph (b)(2) of this section for the treatment of a contemporaneous noncovered modification.

(iv) *Example 4: Consent fee*—(A) *Facts*. The facts are the same as in paragraph (j)(6)(iii)(A) of this section (*Example 3*), except that, instead of proposing to increase the interest rate paid to each consenting holder by the inducement spread, B proposes to make a cash payment to each consenting holder (the *consent fee*) at the time of the modification. Thus, when the proposed modification occurs on July 1, 2022, B pays all holders, including L, the consent fee. Once all modifications are effective, the debt instrument pays interest at a rate of six-month CME Term SOFR plus 142.826 basis points.

(B) *Analysis*. As concluded in paragraph (j)(6)(i)(B) of this section (*Example 1*), the LIBOR replacement modification with basis adjustment spread is a covered modification of L's debt instrument. However, B's obligation to pay the consent fee is also a modification of L's debt instrument but is not a covered modification because it is not described in paragraph (h)(1)(i) of this section. In particular, B's obligation to pay the consent fee is not an associated modification because it is not a modification of the technical, administrative, or operational terms of L's debt instrument and is not intended to compensate for valuation differences resulting from a modification of the administrative terms of L's contract. Nor is the consent fee a qualified one-time payment because it is not intended to compensate L for any part of the basis difference between the discontinued IBOR identified in paragraph (h)(1)(i) of this section (*i.e.*, six-month USD LIBOR) and the interest rate benchmark to which the qualified rate refers (*i.e.*, six-month CME Term SOFR). See paragraph (b)(2) of this section for the treatment of a contemporaneous noncovered modification.

(v) *Example 5: Compensation for a modification to a customary financial covenant*—(A) *Facts*. The facts are the same as in paragraph (j)(6)(i)(A) of this section (*Example 1*), except that, at the same time as and for reasons unrelated to the LIBOR replacement modification with basis adjustment spread, B and L also modify customary financial covenants in the debt instrument in a manner that benefits B. In exchange for the modification of customary financial covenants, B agrees to add another 30 basis points to the rate such that, once all modifications are effective, the debt instrument pays interest at a rate of six-month CME Term SOFR plus 172.826 basis points.

(B) *Analysis*. As concluded in paragraph (j)(6)(i)(B) of this section (*Example 1*), the portion of these modifications that implements the LIBOR replacement modification with basis adjustment spread is a covered modification of the debt instrument. However, the portion of these modifications that modifies customary financial covenants is not related to the replacement of LIBOR and, therefore, is not described in any of paragraphs (h)(1)(i), (ii), or (iii) of this section and, therefore, is a noncovered modification of the debt instrument. Moreover, the portion of these modifications that adds 30 basis points to the rate changes the amount of cash flows on the debt instrument, and the parties intend that change to compensate L for a modification to the debt instrument not described in paragraph (h)(1)(i), (ii), or (iii) of this section (*i.e.*, the modification of customary financial covenants). Therefore, the portion of these modifications that adds those 30 basis points to the rate is described in paragraph (j)(2) of this section and, consequently, is a noncovered modification of the debt instrument. See paragraph (b)(2) of this section for the treatment of a contemporaneous noncovered modification.

(vi) *Example 6: Workout of distressed debt*—(A) *Facts*. The facts are the same as in paragraph (j)(6)(i)(A) of this section (*Example 1*), except that B's financial condition has deteriorated since the issue date of the debt instrument and, to decrease the risk of B's default or bankruptcy, L agrees to subtract 50 basis points from the rate such that, once all modifications are effective, the debt instrument pays interest at a rate of six-month CME Term SOFR plus 92.826 basis points.

(B) *Analysis*. As concluded in paragraph (j)(6)(i)(B) of this section (*Example 1*), the portion of these modifications that implements the LIBOR replacement modification with basis adjustment spread is a covered modification of the debt instrument. However, the portion of these modifications that subtracts 50 basis points from the rate changes the amount of cash flows on the debt instrument, and that change is a concession granted to B because B is experiencing financial difficulty. Therefore, the portion of these modifications that subtracts those 50 basis points from the rate is described in paragraph (j)(3) of this section and, consequently, is a noncovered modification of the debt instrument. See paragraph (b)(2) of this section for the treatment of a contemporaneous noncovered modification.

(vii) *Example 7: Change in rights or obligations not derived from the modified contract*—(A) *Facts*. B is the issuer and L is the holder of a debt instrument (*Debt X*) with respect to which the facts are the same as in paragraph (j)(6)(i)(A) of this section (*Example 1*). In addition, B and L are the issuer and holder, respectively, of a second debt instrument (*Debt Y*). At the same time that the LIBOR replacement modification with basis adjustment spread occurs with respect to Debt X, B and L also modify customary financial covenants in Debt Y in a manner that benefits B. In exchange for the modification of customary financial covenants in Debt Y, B agrees to add another 30 basis points to the rate on Debt X such that, once all modifications are effective, Debt X pays interest at a rate of six-month CME Term SOFR plus 172.826 basis points.

(B) *Analysis*. As concluded in paragraph (j)(6)(i)(B) of this section (*Example 1*), the portion of these modifications that implements the LIBOR replacement modification with basis adjustment spread is a covered modification of Debt X. However, the portion of these modifications that adds 30 basis points to the rate on Debt X changes the amount of cash flows on Debt X, and the parties intend that change to compensate L for a change in rights or obligations that are not derived from Debt X (*i.e.*, the modification of customary financial covenants in Debt Y). Therefore, the portion of these modifications that adds those 30 basis points to the rate on Debt X is described in paragraph (j)(4) of this section and, consequently, is a noncovered modification of Debt X. See paragraph (b)(2) of this section for the treatment of a contemporaneous noncovered modification.

(k) *Applicability date*. This section applies to a modification of the terms of a contract that occurs on or after March 7, 2022. A taxpayer may choose to apply this section to modifications of the terms of contracts that occur before March 7, 2022, provided that the taxpayer and all related parties (within the meaning of section 267(b) or section 707(b)(1) or within the meaning of §1.150–1(b) for a taxpayer that is a State or local governmental unit (as defined in §1.103–1(a)) or a 501(c)(3) organization (as defined in section 150(a)(4))) apply this section to all modifications of the terms of contracts that occur before that date. See section 7805(b)(7).

[T.D. 9961, 87 FR 176, Jan. 4, 2022]

§ 1.1002–1 Sales or exchanges.

(a) *General rule*. The general rule with respect to gain or loss realized upon the sale or exchange of property as determined under section 1001 is that the entire amount of such gain or loss is recognized except in cases where specific provisions of subtitle A of the code provide otherwise.

(b) *Strict construction of exceptions from general rule*. The exceptions from the general rule requiring the recognition of all gains and losses, like other