

(4) Forward contract

The term “forward contract” means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

(e) Net underlying long-term capital gain

For purposes of this section, in the case of any constructive ownership transaction with respect to any financial asset, the term “net underlying long-term capital gain” means the aggregate net capital gain that the taxpayer would have had if—

(1) the financial asset had been acquired for fair market value on the date such transaction was opened and sold for fair market value on the date such transaction was closed, and

(2) only gains and losses that would have resulted from the deemed ownership under paragraph (1) were taken into account.

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

(f) Special rule where taxpayer takes delivery

Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and

(2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset.

(Added Pub. L. 106-170, title V, § 534(a), Dec. 17, 1999, 113 Stat. 1931; amended Pub. L. 108-357, title IV, § 413(c)(23), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 110-172, § 11(a)(23), (24)(B), Dec. 29, 2007, 121 Stat. 2486.)

Editorial Notes

AMENDMENTS

2007—Subsec. (c)(2)(G). Pub. L. 110-172 substituted “subsection (d)” for “subsection (e)” and inserted “and” at end.

2004—Subsec. (c)(2)(H) to (J). Pub. L. 108-357 redesignated subpar. (J) as (H) and struck out former subpars. (H) and (I), which included foreign personal holding company and foreign investment company (as defined in section 1246(b)) within definition of “pass-thru entity”.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE

Pub. L. 106-170, title V, § 534(c), Dec. 17, 1999, 113 Stat. 1934, provided that: “The amendments made by this section [enacting this section] shall apply to transactions entered into after July 11, 1999.”

PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

Subpart

- A. Original issue discount.
- B. Market discount on bonds.
- C. Discount on short-term obligations.
- D. Miscellaneous provisions.

Editorial Notes

AMENDMENTS

1986—Pub. L. 99-514, title XVIII, § 1899A(72), Oct. 22, 1986, 100 Stat. 2963, inserted “on bonds” after “discount” in item for subpart B.

SUBPART A—ORIGINAL ISSUE DISCOUNT

Sec.

- 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments.
- 1272. Current inclusion in income of original issue discount.
- 1273. Determination of amount of original issue discount.
- 1274. Determination of issue price in the case of certain debt instruments issued for property.
- 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.
- 1275. Other definitions and special rules.

Editorial Notes

AMENDMENTS

1985—Pub. L. 99-121, title I, § 102(d), Oct. 11, 1985, 99 Stat. 509, added item 1274A.

§ 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments**(a) General rule**

For purposes of this title—

(1) Retirement

Amounts received by the holder on retirement of any debt instrument shall be considered as amounts received in exchange therefor.

(2) Ordinary income on sale or exchange where intention to call before maturity**(A) In general**

If at the time of original issue there was an intention to call a debt instrument before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to—

- (i) the original issue discount, reduced by

(ii) the portion of original issue discount previously includible in the gross income of any holder (without regard to section 1272(a)(7) (or the corresponding provisions of prior law)),

shall be treated as ordinary income.

(B) Exceptions

This paragraph shall not apply to—

- (i) any tax-exempt obligation, or
- (ii) any holder who has purchased the debt instrument at a premium.

(3) Certain short-term Government obligations

(A) In general

On the sale or exchange of any short-term Government obligation, any gain realized which does not exceed an amount equal to the ratable share of the acquisition discount shall be treated as ordinary income.

(B) Short-term Government obligation

For purposes of this paragraph, the term “short-term Government obligation” means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, which has a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation.

(C) Acquisition discount

For purposes of this paragraph, the term “acquisition discount” means the excess of the stated redemption price at maturity over the taxpayer’s basis for the obligation.

(D) Ratable share

For purposes of this paragraph, except as provided in subparagraph (E), the ratable share of the acquisition discount is an amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date the taxpayer acquired the obligation and up to (and including) the date of its maturity.

(E) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the acquisition discount is the portion of the acquisition discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the taxpayer’s yield to maturity based on the taxpayer’s cost of acquiring the obligation, and
- (ii) compounding daily.

An election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(4) Certain short-term nongovernment obligations

(A) In general

On the sale or exchange of any short-term nongovernment obligation, any gain realized

which does not exceed an amount equal to the ratable share of the original issue discount shall be treated as ordinary income.

(B) Short-term nongovernment obligation

For purposes of this paragraph, the term “short-term nongovernment obligation” means any obligation which—

- (i) has a fixed maturity date not more than 1 year from the date of the issue, and
- (ii) is not a short-term Government obligation (as defined in paragraph (3)(B) without regard to the last sentence thereof).

(C) Ratable share

For purposes of this paragraph, except as provided in subparagraph (D), the ratable share of the original issue discount is an amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date of original issue and up to (and including) the date of its maturity.

(D) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the original issue discount is the portion of the original issue discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the yield to maturity based on the issue price of the obligation, and
- (ii) compounding daily.

Any election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(b) Exception for certain obligations

(1) In general

This section shall not apply to any obligation issued by a natural person before June 9, 1997.

(2) Termination

Paragraph (1) shall not apply to any obligation purchased (within the meaning of section 1272(d)(1))¹ after June 8, 1997.

(c) Double inclusion in income not required

This section and sections 1272 and 1286 shall not require the inclusion of any amount previously includible in gross income.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 531; amended Pub. L. 99-514, title XVIII, §1803(a)(1)(A), (2), (3), Oct. 22, 1986, 100 Stat. 2791, 2792; Pub. L. 100-647, title I, §1006(u)(4), Nov. 10, 1988, 102 Stat. 3427; Pub. L. 105-34, title X, §1003(c)(1), Aug. 5, 1997, 111 Stat. 910; Pub. L. 113-295, div. A, title II, §221(a)(86), Dec. 19, 2014, 128 Stat. 4049; Pub. L. 115-141, div. U, title IV, §401(c)(1)(A), (D), (E), Mar. 23, 2018, 132 Stat. 1205.)

¹ See References in Text note below.

Editorial Notes

REFERENCES IN TEXT

Section 1272(d), referred to in subsec. (b)(2), was redesignated section 1272(c) by Pub. L. 115-141, div. U, title IV, § 401(c)(1)(B), Mar. 23, 2018, 132 Stat. 1205.

AMENDMENTS

2018—Subsec. (a)(2)(A)(ii). Pub. L. 115-141, § 401(c)(1)(D), substituted “section 1272(a)(7)” for “subsection (a)(7) or (b)(4) of section 1272”.

Subsec. (a)(2)(B). Pub. L. 115-141, § 401(c)(1)(A)(ii), struck out “(and paragraph (2) of subsection (c))” after “This paragraph” in introductory provisions.

Subsec. (b)(1). Pub. L. 115-141, § 401(c)(1)(E), amended par. (1) generally. Prior to amendment, text read as follows: “This section shall not apply to—

“(A) any obligation issued by a natural person before June 9, 1997, and

“(B) any obligation issued before July 2, 1982, by an issuer which is not a corporation and is not a government or political subdivision thereof.”

Subsecs. (c), (d). Pub. L. 115-141, § 401(c)(1)(A)(i), redesignated subsec. (d) as (c) and struck out former subsec. (c) which related to special rule for certain obligations with respect to which original issue discount not currently includible.

2014—Subsec. (c). Pub. L. 113-295 amended subsec. (c) generally. Prior to amendment, subsec. (c) related to transition rules, including special rules for certain obligations issued before Jan. 1, 1955, and for certain obligations with respect to which original issue discount was not currently includible.

1997—Subsec. (b). Pub. L. 105-34 amended heading and text of subsec. (b) generally. Prior to amendment, text read as follows: “This section shall not apply to—

“(1) NATURAL PERSONS.—Any obligation issued by a natural person.

“(2) OBLIGATIONS ISSUED BEFORE JULY 2, 1982, BY CERTAIN ISSUERS.—Any obligation issued before July 2, 1982, by an issuer which—

“(A) is not a corporation, and

“(B) is not a government or political subdivision thereof.”

1988—Subsec. (a)(2)(A)(ii). Pub. L. 100-647 substituted “subsection (a)(7)” for “subsection (a)(6)”.

1986—Subsec. (a)(3)(B). Pub. L. 99-514, § 1803(a)(3), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “For purposes of this paragraph, the term ‘short-term Government obligation’ means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia which is—

“(i) issued on a discount basis, and

“(ii) payable without interest at a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation.”

Subsec. (a)(3)(D). Pub. L. 99-514, § 1803(a)(2)(B), inserted “except as provided in subparagraph (E).”

Subsec. (a)(3)(E). Pub. L. 99-514, § 1803(a)(2)(A), added subpar. (E).

Subsec. (a)(4). Pub. L. 99-514, § 1803(a)(1)(A), added par. (4).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2018 AMENDMENT

Amendment by Pub. L. 115-141 applicable to debt instruments issued on or after July 2, 1982, see section 401(c)(1)(H) of Pub. L. 115-141, set out as a note under section 163 of this title.

EFFECTIVE DATE OF 2014 AMENDMENT

Amendment by Pub. L. 113-295 effective Dec. 19, 2014, subject to a savings provision, see section 221(b) of Pub. L. 113-295, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title X, § 1003(c)(2), Aug. 5, 1997, 111 Stat. 911, provided that: “The amendment made by

paragraph (1) [amending this section] shall apply to sales, exchanges, and retirements after the date of enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Pub. L. 98-369, div. A, title I, § 44, July 18, 1984, 98 Stat. 559, as amended by Pub. L. 98-612, § 2, Oct. 31, 1984, 98 Stat. 3182; Pub. L. 99-514, § 2, title XVIII, § 1803(b), Oct. 22, 1986, 100 Stat. 2095, 2797, provided that:

“(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this subtitle [subtitle C (§§ 41-44) of title I of div. A of Pub. L. 98-369, enacting this section and sections 1272 to 1288 and 6706, amending sections 103A, 163, 165, 249, 341, 405, 409, 453B, 483, 751, 811, 871, 881, 1016, 1037, 1351, 1441, 6049, 7701, and 7805, and repealing sections 1232, 1232A, and 1232B of this title] shall apply to taxable years ending after the date of the enactment of this Act [July 18, 1984].

“(b) TREATMENT OF DEBT INSTRUMENTS RECEIVED IN EXCHANGE FOR PROPERTY.—

“(1) IN GENERAL.—

“(A) Except as otherwise provided in this subsection, section 1274 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by section 41) and the amendment made by section 41(b) (relating to amendment of section 483) shall apply to sales or exchanges after December 31, 1984.

“(B) Section 1274 of such Code and the amendment made by section 41(b) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(2) REVISION OF SECTION 482 REGULATIONS.—Not later than 180 days after the date of the enactment of this Act [July 18, 1984], the Secretary of the Treasury or his delegate shall modify the safe harbor interest rates applicable under the regulations prescribed under section 482 of the Internal Revenue Code of 1986 so that such rates are consistent with the rates applicable under section 483 of such Code by reason of the amendments made by section 41.

“(3) CLARIFICATION OF INTEREST ACCRUAL; FAIR MARKET VALUE RULE IN CASE OF POTENTIALLY ABUSIVE SITUATIONS.—

“(A) IN GENERAL.—

“(i) CLARIFICATION OF INTEREST ACCRUAL.—In the case of any sale or exchange—

“(I) after March 1, 1984, nothing in section 483 of the Internal Revenue Code of 1986 shall permit any interest to be deductible before the period to which such interest is properly allocable, or

“(II) after June 8, 1984, notwithstanding section 483 of the Internal Revenue Code of 1986 or any other provision of law, no interest shall be deductible before the period to which such interest is properly allocable.

“(ii) FAIR MARKET RULE.—In the case of any sale or exchange after March 1, 1984, such section 483 shall be treated as including provisions similar to the provisions of section 1274(b)(3) of such Code (as added by section 41).

“(B) EXCEPTION FOR BINDING CONTRACTS.—

“(i) Subparagraph (A)(i)(I) shall not apply to any sale or exchange pursuant to a written con-

tract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(ii) Subparagraph (A)(i)(II) shall not apply to any sale or exchange pursuant to a written contract which was binding on June 8, 1984, and at all times thereafter before the sale or exchange.

“(C) INTEREST ACCRUAL RULE NOT TO APPLY WHERE SUBSTANTIALLY EQUAL ANNUAL PAYMENTS.—Clause (i) of subparagraph (A) shall not apply to any debt instrument with substantially equal annual payments.

“(4) SPECIAL RULES FOR SALES AFTER DECEMBER 31, 1984, AND BEFORE JULY 1, 1985.—

“(A) IN GENERAL.—In the case of any sale or exchange after December 31, 1984, and before July 1, 1985, of property other than new section 38 property—

“(i) sections 483(c)(1)(B) and 1274(c)(3) of the Internal Revenue Code of 1986 shall be applied by substituting the testing rate determined under subparagraph (B) for 110 percent of the applicable Federal rate determined under section 1274(d) of such Code, and

“(ii) sections 483(b) and 1274(b) of such Code shall be applied by substituting the imputation rate determined under subparagraph (C) for 120 percent of the applicable Federal rate determined under section 1274(d) of such Code.

“(B) TESTING RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The testing rate determined under this subparagraph is the sum of—

“(I) 9 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 110 percent of the applicable Federal rate determined under section 1274(d) of such Code over 9 percent.

“(C) IMPUTATION RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The imputation rate determined under this subparagraph is the sum of—

“(I) 10 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 120 percent of the applicable Federal rate determined under section 1274(d) of such Code over 10 percent.

“(D) BORROWED AMOUNT.—For purposes of this paragraph, the term ‘borrowed amount’ means the stated principal amount.

“(E) AGGREGATION RULES.—For purposes of this paragraph—

“(i) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as one sale or exchange, and

“(ii) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as one debt instrument.

“(F) CASH METHOD OF ACCOUNTING.—In the case of any sale or exchange before July 1, 1985, of property (other than new section 38 property) used in the active business of farming and in which the borrowed amount does not exceed \$2,000,000—

“(i) section 1274 of the Internal Revenue Code of 1986 shall not apply, and

“(ii) interest on the obligation issued in connection with such sale or exchange shall be taken

into account by both buyer and seller on the cash receipts and disbursements method of accounting. The Secretary of the Treasury or his delegate may by regulation prescribe rules to prevent the mismatching of interest income and interest deductions in connection with obligations on which interest is computed on the cash receipts and disbursements method of accounting.

“(G) CLARIFICATION OF APPLICATION OF THIS PARAGRAPH, ETC.—This paragraph and paragraphs (5), (6), and (7) shall apply only in the case of sales or exchanges to which section 1274 or 483 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by section 41) applies.

“(5) GENERAL RULE FOR ASSUMPTIONS OF LOANS.—Except as provided in paragraphs (6) and (7), if any person—

“(A) assumes, in connection with the sale or exchange of property, any debt obligation, or

“(B) acquires any property subject to any debt obligation, sections 1274 and 483 of the Internal Revenue Code of 1986 shall apply to such debt obligation by reason of such assumption (or such acquisition).

“(6) EXCEPTION FOR ASSUMPTIONS OF LOANS MADE ON OR BEFORE OCTOBER 15, 1984.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property, any debt obligation described in subparagraph (B) and issued on or before October 15, 1984, or

“(ii) acquires any property subject to any such debt obligation issued on or before October 15, 1984,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) OBLIGATIONS DESCRIBED IN THIS SUBPARAGRAPH.—A debt obligation is described in this subparagraph if such obligation—

“(i) was issued on or before October 15, 1984, and

“(ii) was assumed (or property was taken subject to such obligation) in connection with the sale or exchange of property (including a deemed sale under section 338 (a)) the sales price of which is not greater than \$100,000,000.

“(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to effect the purpose of this paragraph and paragraph (5), including regulations relating to tax-exempt obligations, government subsidized loans, or other instruments.

“(D) CERTAIN EXEMPT TRANSACTIONS.—The Secretary shall prescribe regulations under which any transaction shall be exempt from the application of this paragraph if such exemption is not likely to significantly reduce the tax liability of the purchaser by reason of the overstatement of the adjusted basis of the acquired asset.

“(7) EXCEPTION FOR ASSUMPTIONS OF LOANS WITH RESPECT TO CERTAIN PROPERTY.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property described in subparagraph (B), any debt obligation, or

“(ii) acquires any such property subject to any such debt obligation,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) SALES OR EXCHANGES TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply to any of the following sales or exchanges:

“(i) RESIDENCES.—Any sale or exchange of a residence by an individual, an estate, or a testamentary trust, but only if—

“(I) either—

“(aa) such residence on the date of such sale or exchange (or in the case of an estate or testamentary trust, on the date of death of the decedent) was the principal residence (within the meaning of section 1034) of the individual or decedent, or

“(bb) during the 2-year period ending on such date, no substantial portion of such residence was of a character subject to an allowance under this title [probably means the Internal Revenue Code of 1986] for depreciation (or amortization in lieu thereof) in the hands of such individual or decedent, and

“(II) such residence was not at any time, in the hands of such individual, estate, testamentary trust, or decedent, described in section 1221(l) (relating to inventory, etc.).

“(ii) FARMS.—Any sale or exchange by a qualified person of—

“(I) real property which was used as a farm (within the meaning of section 6420(c)(2)) at all times during the 3-year period ending on the date of such sale or exchange, or

“(II) tangible personal property which was used in the active conduct of the trade or business of farming on such farm and is sold in connection with the sale of such farm,

but only if such property is sold or exchanged for use in the active conduct of the trade or business of farming by the transferee of such property.

“(iii) TRADES OR BUSINESSES.—

“(I) IN GENERAL.—Any sale or exchange by a qualified person of any trade or business.

“(II) APPLICATION WITH SUBPARAGRAPH (B).—This subparagraph shall not apply to any sale or exchange of any property described in subparagraph (B).

“(III) NEW SECTION 38 PROPERTY.—This subparagraph shall not apply to the sale or exchange of any property which, in the hands of the transferee, is new section 38 property.

“(iv) SALE OF BUSINESS REAL ESTATE.—Any sale or exchange of any real property used in an active trade or business by a person who would be a qualified person if he disposed of his entire interest.

This subparagraph shall not apply to any transaction described in the last sentence of paragraph (6)(B) (relating to transaction in excess of \$100,000,000).

“(C) DEFINITIONS.—For purposes of this paragraph—

“(i) QUALIFIED PERSON DEFINED.—The term ‘qualified person’ means—

“(I) a person who—

“(aa) is an individual, estate, or testamentary trust,

“(bb) is a corporation which immediately prior to the date of the sale or exchange has 35 or fewer shareholders, or

“(cc) is a partnership which immediately prior to the date of the sale or exchange has 35 or fewer partners,

“(II) is a 10-percent owner of a farm or a trade or business,

“(III) pursuant to a plan, disposes of—

“(aa) an interest in a farm or farm property, or

“(bb) his entire interest in a trade or business and all substantially similar trades or businesses, and

“(IV) the ownership interest of whom may be readily established by reason of qualified allocations (of the type described in section 168(j)(9)(B), one class of stock, or the like).

“(ii) 10-PERCENT OWNER DEFINED.—The term ‘10-percent owner’ means a person having at least a 10-percent ownership interest, applying the attribution rules of section 318 (other than subsection (a)(4)).

“(iii) TRADE OR BUSINESS DEFINED.—

“(I) IN GENERAL.—The term ‘trade or business’ means any trade or business, including any line of business, qualifying as an active trade or business within the meaning of section 355.

“(II) RENTAL OF REAL PROPERTY.—For purposes of this clause, the holding of real property for rental shall not be treated as an active trade or business.

“(c) MARKET DISCOUNT RULES.—

“(1) ORDINARY INCOME TREATMENT.—Section 1276 of the Internal Revenue Code of 1986 (as added by section 41) shall apply to obligations issued after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date.

“(2) INTEREST DEFERRAL RULES.—Section 1277 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act in taxable years ending after such date.

“(d) RULES RELATING TO DISCOUNT ON SHORT-TERM OBLIGATIONS.—Subpart C of part V of subchapter P of chapter 1 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act [July 18, 1984].

“(e) 5-YEAR SPREAD OF ADJUSTMENTS REQUIRED BY REASON OF ACCRUAL OF DISCOUNT ON CERTAIN SHORT-TERM OBLIGATIONS.—

“(1) ELECTION TO HAVE SECTION 1281 APPLY TO ALL OBLIGATIONS HELD DURING TAXABLE YEAR.—A taxpayer may elect for his first taxable year ending after the date of the enactment of this Act [July 18, 1984] to have section 1281 of the Internal Revenue Code of 1986 apply to all short-term obligations described in subsection (b) of such section which were held by the taxpayer at any time during such first taxable year.

“(2) 5-YEAR SPREAD.—

“(A) IN GENERAL.—In the case of any taxpayer who makes an election under paragraph (1)—

“(i) the provisions of section 1281 of the Internal Revenue Code of 1986 (as added by section 41) shall be treated as a change in the method of accounting of the taxpayer,

“(ii) such change shall be treated as having been made with the consent of the Secretary, and

“(iii) the net amount of the adjustments required by section 481(a) of such Code to be taken into account by the taxpayer in computing taxable income (hereinafter in this paragraph referred to as the ‘net adjustments’) shall be taken into account during the spread period with the amount taken into account in each taxable year in such period determined under subparagraph (B).

“(B) AMOUNT TAKEN INTO ACCOUNT DURING EACH YEAR OF SPREAD PERIOD.—

“(i) FIRST YEAR.—The amount taken into account for the first taxable year in the spread period shall be the sum of—

“(I) one-fifth of the net adjustments, and

“(II) the excess (if any) of—

“(a) the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments.

“(ii) FOR SUBSEQUENT YEARS IN SPREAD PERIOD.—The amount taken into account in the second or any succeeding taxable year in the spread period shall be the sum of—

“(I) the portion of the net adjustments not taken into account in the preceding taxable year of the spread period divided by the number of remaining taxable years in the spread period (including the year for which the determination is being made), and

“(II) the excess (if any) of—

“(a) the excess of the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments, multiplied by 5 minus the number of years remain-

ing in the spread period (not including the current year).

The excess described in subparagraph (B)(ii)(II)(a) shall be reduced by any amount taken into account under this subclause or clause (i)(II) in any prior year.

“(C) SPREAD PERIOD.—For purposes of this paragraph, the term ‘spread period’ means the period consisting of the 5 taxable years beginning with the year for which the election is made under paragraph (1).

“(D) CASH BASIS INCOME.—For purposes of this paragraph, the term ‘cash basis income’ means for any taxable year the aggregate amount which would be includible in the gross income of the taxpayer with respect to short-term obligations described in subsection (b) of section 1281 of such Code if the provisions of section 1281 of such Code did not apply to such taxable year and all prior taxable years within the spread period.

“(E) ACCRUAL BASIS INCOME.—For purposes of this paragraph, the term ‘accrual basis income’ means for any taxable year the aggregate amount includible in gross income under section 1281(a) of such Code for such a taxable year and all prior taxable years within the spread period.

“(f) TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.—Section 1288 of such Code (as added by section 41) shall apply to obligations issued after September 3, 1982, and acquired after March 1, 1984.

“(g) REPEAL OF CAPITAL ASSET REQUIREMENT.—Section 1272 of such Code (as added by section 41) shall not apply to any obligation issued on or before December 31, 1984, which is not a capital asset in the hands of the taxpayer.

“(h) REPORTING REQUIREMENTS.—Section 1275(c) of such Code (as added by section 41) and the amendments made by section 41(c) [enacting section 6706 of this title] shall take effect on the day 30 days after the date of the enactment of this Act [July 18, 1984].

“(i) OTHER MISCELLANEOUS CHANGES.—

“(1) ACCRUAL PERIOD.—In the case of any obligation issued after July 1, 1982, and before January 1, 1985, the accrual period, for purposes of section 1272(a) of the Internal Revenue Code of 1986 (as amended by section 41(a)), shall be a 1-year period (or shorter period to maturity) beginning on the day in the calendar year which corresponds to the date of original issue of the obligation.

“(2) CHANGE IN REDUCTION FOR PURCHASE AFTER ORIGINAL ISSUE.—Section 1272(a)(6) of such Code (as so amended) shall not apply to any purchase on or before the date of the enactment of this Act [July 18, 1984], and the rules of section 1232A(a)(6) of such Code (as in effect on the day before the date of the enactment of this Act) shall continue to apply to such purchase.

“(j) CLARIFICATION THAT PRIOR EFFECTIVE DATE RULES NOT AFFECTED.—Nothing in the amendment made by section 41(a) shall affect the application of any effective date provision (including any transitional rule) for any provision which was a predecessor to any provision contained in part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (as added by section 41).”

[Amendment of section 44 of Pub. L. 98-369, set out above, by Pub. L. 98-612 (which added pars. (4) to (7) to subsec. (b)) not applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.]

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L.

99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1272. Current inclusion in income of original issue discount

(a) Original issue discount included in income on basis of constant interest rate

(1) General rule

For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

(2) Exceptions

Paragraph (1) shall not apply to—

(A) Tax-exempt obligations

Any tax-exempt obligation.

(B) United States savings bonds

Any United States savings bond.

(C) Short-term obligations

Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

(D) Loans between natural persons

(i) In general

Any loan made by a natural person to another natural person if—

(I) such loan is not made in the course of a trade or business of the lender, and

(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed \$10,000.

(ii) Clause (i) not to apply where tax avoidance a principal purpose

Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

(iii) Treatment of husband and wife

For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

(3) Determination of daily portions

For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

(A) the product of—

(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

(4) Adjusted issue price

For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

(A) the issue price of such debt instrument, plus

(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

(5) Accrual period

Except as otherwise provided in regulations prescribed by the Secretary, the term “accrual period” means a 6-month period (or shorter period from the date of original issue of the debt instrument) which ends on a day in the calendar year corresponding to the maturity date of the debt instrument or the date 6 months before such maturity date.

(6) Determination of daily portions where principal subject to acceleration

(A) In general

In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of—

(i) the sum of (I) the present value determined under subparagraph (B) of all remaining payments under the debt instrument as of the close of such period, and (II) the payments during the accrual period of amounts included in the stated redemption price of the debt instrument, over

(ii) the adjusted issue price of such debt instrument at the beginning of such period.

(B) Determination of present value

For purposes of subparagraph (A), the present value shall be determined on the basis of—

(i) the original yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period),

(ii) events which have occurred before the close of the accrual period, and

(iii) a prepayment assumption determined in the manner prescribed by regulations.

(C) Debt instruments to which paragraph applies

This paragraph applies to—

(i) any regular interest in a REMIC or qualified mortgage held by a REMIC,

(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt in-

strument (or, to the extent provided in regulations, by reason of other events), or

(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.

(7) Reduction where subsequent holder pays acquisition premium

(A) Reduction

For purposes of this subsection, in the case of any purchase after its original issue of a debt instrument to which this subsection applies, the daily portion for any day shall be reduced by an amount equal to the amount which would be the daily portion for such day (without regard to this paragraph) multiplied by the fraction determined under subparagraph (B).

(B) Determination of fraction

For purposes of subparagraph (A), the fraction determined under this subparagraph is a fraction—

(i) the numerator of which is the excess (if any) of—

(I) the cost of such debt instrument incurred by the purchaser, over

(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph), and

(ii) the denominator of which is the sum of the daily portions for such debt instrument for all days after the date of such purchase and ending on the stated maturity date (computed without regard to this paragraph).

(b) Exceptions

This section shall not apply to any holder—

(1) who has purchased the debt instrument at a premium, or

(2) which is a life insurance company to which section 811(b) applies.

(c) Definition and special rule

(1) Purchase defined

For purposes of this section, the term “purchase” means—

(A) any acquisition of a debt instrument, where

(B) the basis of the debt instrument is not determined in whole or in part by reference to the adjusted basis of such debt instrument in the hands of the person from whom acquired.

(2) Basis adjustment

The basis of any debt instrument in the hands of the holder thereof shall be increased

by the amount included in his gross income pursuant to this section.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 533; amended Pub. L. 99-514, title VI, §672, Oct. 22, 1986, 100 Stat. 2318; Pub. L. 105-34, title X, §1004(a), Aug. 5, 1997, 111 Stat. 911; Pub. L. 115-141, div. U, title IV, §401(c)(1)(B), (F), (3)(A), Mar. 23, 2018, 132 Stat. 1205, 1206.)

Editorial Notes

AMENDMENTS

2018—Subsec. (a), Pub. L. 115-141, §401(c)(1)(F)(i), struck out “on debt instruments issued after July 1, 1982,” after “discount” in heading.

Subsec. (a)(1), Pub. L. 115-141, §401(c)(1)(F)(ii), struck out “issued after July 1, 1982” before “, an amount equal to”.

Subsec. (a)(2)(D), (E), Pub. L. 115-141, §401(c)(3)(A), redesignated subpar. (E) as (D) and struck out former subpar. (D). Prior to amendment, text of subpar. (D) read as follows: “Any obligation issued by a natural person before March 2, 1984.”

Subsecs. (b) to (d), Pub. L. 115-141, §401(c)(1)(B), redesignated subsecs. (c) and (d) as (b) and (c), respectively, and struck out former subsec. (b) which related to ratable inclusion retained for corporate debt instruments issued before July 2, 1982.

1997—Subsec. (a)(6)(C), Pub. L. 105-34 added cl. (iii) and concluding provisions.

1986—Subsec. (a)(6), (7), Pub. L. 99-514 added par. (6) and redesignated former par. (6) as (7).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2018 AMENDMENT

Amendment by section 401(c)(1)(B), (F) of Pub. L. 115-141 applicable to debt instruments issued on or after July 2, 1982, see section 401(c)(1)(H) of Pub. L. 115-141, set out as a note under section 163 of this title.

Amendment by section 401(c)(3)(A) of Pub. L. 115-141 applicable to obligations issued on or after Mar. 2, 1984, see section 401(c)(3)(C) of Pub. L. 115-141, set out as a note under section 163 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title X, §1004(b)(1), Aug. 5, 1997, 111 Stat. 911, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to debt instruments issued after Dec. 31, 1986, in taxable years ending after such date, see section 675(b) of Pub. L. 99-514, set out as an Effective Date note under section 860A of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, but not applicable to any obligation issued on or before Dec. 31, 1984, which is not a capital asset in the hands of the taxpayer, and subsec. (a)(6) of this section not applicable to any purchase on or before July 18, 1984, see section 44 of Pub. L. 98-369, as amended, set out as a note under section 1271 of this title.

CHANGE IN METHOD OF ACCOUNTING

Pub. L. 105-34, title X, §1004(b)(2), Aug. 5, 1997, 111 Stat. 911, provided that: “In the case of any taxpayer required by this section [amending this section and enacting provisions set out as a note above] to change its method of accounting for its first taxable year beginning after the date of the enactment of this Act [Aug. 5, 1997]—

“(A) such change shall be treated as initiated by the taxpayer,

“(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

“(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.”

§ 1273. Determination of amount of original issue discount

(a) General rule

For purposes of this subpart—

(1) In general

The term “original issue discount” means the excess (if any) of—

(A) the stated redemption price at maturity, over

(B) the issue price.

(2) Stated redemption price at maturity

The term “stated redemption price at maturity” means the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time (other than any interest based on a fixed rate, and payable unconditionally at fixed periodic intervals of 1 year or less during the entire term of the debt instrument).

(3) ¼ of 1 percent de minimis rule

If the original issue discount determined under paragraph (1) is less than—

(A) ¼ of 1 percent of the stated redemption price at maturity, multiplied by

(B) the number of complete years to maturity,

then the original issue discount shall be treated as zero.

(b) Issue price

For purposes of this subpart—

(1) Publicly offered debt instruments not issued for property

In the case of any issue of debt instruments—

(A) publicly offered, and

(B) not issued for property,

the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instruments was sold.

(2) Other debt instruments not issued for property

In the case of any issue of debt instruments not issued for property and not publicly offered, the issue price of each such instrument is the price paid by the first buyer of such debt instrument.

(3) Debt instruments issued for property where there is public trading

In the case of a debt instrument which is issued for property and which—

(A) is part of an issue a portion of which is traded on an established securities market, or

(B)(i) is issued for stock or securities which are traded on an established securities market, or

(ii) to the extent provided in regulations, is issued for property (other than stock or securities) of a kind regularly traded on an established market,

the issue price of such debt instrument shall be the fair market value of such property.

(4) Other cases

Except in any case—

(A) to which paragraph (1), (2), or (3) of this subsection applies, or

(B) to which section 1274 applies,

the issue price of a debt instrument which is issued for property shall be the stated redemption price at maturity.

(5) Property

In applying this subsection, the term “property” includes services and the right to use property, but such term does not include money.

(c) Special rules for applying subsection (b)

For purposes of subsection (b)—

(1) Initial offering price; price paid by the first buyer

The terms “initial offering price” and “price paid by the first buyer” include the aggregate payments made by the purchaser under the purchase agreement, including modifications thereof.

(2) Treatment of investment units

In the case of any debt instrument and an option, security, or other property issued together as an investment unit—

(A) the issue price for such unit shall be determined in accordance with the rules of this subsection and subsection (b) as if it were a debt instrument,

(B) the issue price determined for such unit shall be allocated to each element of such unit on the basis of the relationship of the fair market value of such element to the fair market value of all elements in such unit, and

(C) the issue price of any debt instrument included in such unit shall be the portion of the issue price of the unit allocated to the debt instrument under subparagraph (B).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 536; amended Pub. L. 99-514, title XVIII, §1803(a)(10), Oct. 22, 1986, 100 Stat. 2794.)

Editorial Notes

AMENDMENTS

1986—Subsec. (b)(3)(B). Pub. L. 99-514 amended subpar. (B) generally, designating existing provisions as cl. (i) and adding cl. (ii).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of

Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1274. Determination of issue price in the case of certain debt instruments issued for property

(a) In general

In the case of any debt instrument to which this section applies, for purposes of this subpart, the issue price shall be—

(1) where there is adequate stated interest, the stated principal amount, or

(2) in any other case, the imputed principal amount.

(b) Imputed principal amount

For purposes of this section—

(1) In general

Except as provided in paragraph (3), the imputed principal amount of any debt instrument shall be equal to the sum of the present values of all payments due under such debt instrument.

(2) Determination of present value

For purposes of paragraph (1), the present value of a payment shall be determined in the manner provided by regulations prescribed by the Secretary—

(A) as of the date of the sale or exchange, and

(B) by using a discount rate equal to the applicable Federal rate, compounded semi-annually.

(3) Fair market value rule in potentially abusive situations

(A) In general

In the case of any potentially abusive situation, the imputed principal amount of any debt instrument received in exchange for property shall be the fair market value of such property adjusted to take into account other consideration involved in the transaction.

(B) Potentially abusive situation defined

For purposes of subparagraph (A), the term “potentially abusive situation” means—

(i) a tax shelter (as defined in section 6662(d)(2)(C)(ii)), and

(ii) any other situation which, by reason of—

(I) recent sales transactions,

(II) nonrecourse financing,

(III) financing with a term in excess of the economic life of the property, or

(IV) other circumstances,

is of a type which the Secretary specifies by regulations as having potential for tax avoidance.

(c) Debt instruments to which section applies

(1) In general

Except as otherwise provided in this subsection, this section shall apply to any debt instrument given in consideration for the sale or exchange of property if—

(A) the stated redemption price at maturity for such debt instrument exceeds—

(i) where there is adequate stated interest, the stated principal amount, or

(ii) in any other case, the imputed principal amount of such debt instrument determined under subsection (b), and

(B) some or all of the payments due under such debt instrument are due more than 6 months after the date of such sale or exchange.

(2) Adequate stated interest

For purposes of this section, there is adequate stated interest with respect to any debt instrument if the stated principal amount for such debt instrument is less than or equal to the imputed principal amount of such debt instrument determined under subsection (b).

(3) Exceptions

This section shall not apply to—

(A) Sales for \$1,000,000 or less of farms by individuals or small businesses

(i) In general

Any debt instrument arising from the sale or exchange of a farm (within the meaning of section 6420(c)(2))—

(I) by an individual, estate, or testamentary trust,

(II) by a corporation which as of the date of the sale or exchange is a small business corporation (as defined in section 1244(c)(3)), or

(III) by a partnership which as of the date of the sale or exchange meets requirements similar to those of section 1244(c)(3).

(ii) \$1,000,000 limitation

Clause (i) shall apply only if it can be determined at the time of the sale or exchange that the sales price cannot exceed \$1,000,000. For purposes of the preceding sentence, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(B) Sales of principal residences

Any debt instrument arising from the sale or exchange by an individual of his principal residence (within the meaning of section 121).

(C) Sales involving total payments of \$250,000 or less

(i) In general

Any debt instrument arising from the sale or exchange of property if the sum of the following amounts does not exceed \$250,000:

(I) the aggregate amount of the payments due under such debt instrument

and all other debt instruments received as consideration for the sale or exchange, and

(II) the aggregate amount of any other consideration to be received for the sale or exchange.

(ii) Consideration other than debt instrument taken into account at fair market value

For purposes of clause (i), any consideration (other than a debt instrument) shall be taken into account at its fair market value.

(iii) Aggregation of transactions

For purposes of this subparagraph, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(D) Debt instruments which are publicly traded or issued for publicly traded property

Any debt instrument to which section 1273(b)(3) applies.

(E) Certain sales of patents

In the case of any transfer described in section 1235(a) (relating to sale or exchange of patents), any amount contingent on the productivity, use, or disposition of the property transferred.

(F) Sales or exchanges to which section 483(e) applies

Any debt instrument to the extent section 483(e) (relating to certain land transfers between related persons) applies to such instrument.

(4) Exception for assumptions

If any person—

(A) in connection with the sale or exchange of property, assumes any debt instrument, or

(B) acquires any property subject to any debt instrument,

in determining whether this section or section 483 applies to such debt instrument, such assumption (or such acquisition) shall not be taken into account unless the terms and conditions of such debt instrument are modified (or the nature of the transaction is changed) in connection with the assumption (or acquisition).

(d) Determination of applicable Federal rate

For purposes of this section—

(1) Applicable Federal rate

(A) In general

In the case of a debt instrument with a term of:	The applicable Federal rate is:
Not over 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal mid-term rate.
Over 9 years	The Federal long-term rate.

(B) Determination of rates

During each calendar month, the Secretary shall determine the Federal short-

term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

(C) Federal rate for any calendar month

For purposes of this paragraph—

(i) Federal short-term rate

The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.

(ii) Federal mid-term and long-term rates

The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

(D) Lower rate permitted in certain cases

The Secretary may by regulations permit a rate to be used with respect to any debt instrument which is lower than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such lower rate is based on the same principles as the applicable Federal rate and is appropriate for the term of such instrument.

(2) Lowest 3-month rate applicable to any sale or exchange

(A) In general

In the case of any sale or exchange, the applicable Federal rate shall be the lowest 3-month rate.

(B) Lowest 3-month rate

For purposes of subparagraph (A), the term “lowest 3-month rate” means the lowest of the applicable Federal rates in effect for any month in the 3-calendar-month period ending with the 1st calendar month in which there is a binding contract in writing for such sale or exchange.

(3) Term of debt instrument

In determining the term of a debt instrument for purposes of this subsection, under regulations prescribed by the Secretary, there shall be taken into account options to renew or extend.

(e) 110 Percent rate where sale-leaseback involved

(1) In general

In the case of any debt instrument to which this subsection applies, the discount rate used under subsection (b)(2)(B) or section 483(b) shall be 110 percent of the applicable Federal rate, compounded semiannually.

(2) Lower discount rates shall not apply

Section 1274A shall not apply to any debt instrument to which this subsection applies.

(3) Debt instruments to which this subsection applies

This subsection shall apply to any debt instrument given in consideration for the sale or exchange of any property if, pursuant to a

plan, the transferor or any related person leases a portion of such property after such sale or exchange.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 538; amended Pub. L. 99-121, title I, §§101(a)(1), (b), (c), 102(b), Oct. 11, 1985, 99 Stat. 505, 506, 508; Pub. L. 99-514, title XVIII, §1803(a)(14)(A), Oct. 22, 1986, 100 Stat. 2797; Pub. L. 101-239, title VII, §7721(c)(11), Dec. 19, 1989, 103 Stat. 2400; Pub. L. 104-188, title I, §1704(t)(78), Aug. 20, 1996, 110 Stat. 1891; Pub. L. 105-34, title III, §312(d)(1), Aug. 5, 1997, 111 Stat. 839; Pub. L. 115-141, div. U, title IV, §401(a)(179), Mar. 23, 2018, 132 Stat. 1193.)

Editorial Notes

AMENDMENTS

2018—Subsec. (b)(3)(B)(i). Pub. L. 115-141 substituted “section 6662(d)(2)(C)(ii)” for “section 6662(d)(2)(C)(iii)”.
1997—Subsec. (c)(3)(B). Pub. L. 105-34 substituted “section 121” for “section 1034”.

1996—Subsec. (b)(3)(B)(i). Pub. L. 104-188 substituted “section 6662(d)(2)(C)(iii)” for “section 6662(d)(2)(C)(ii)”.

1989—Subsec. (b)(3)(B)(i). Pub. L. 101-239 substituted “section 6662(d)(2)(C)(ii)” for “section 6661(b)(2)(C)(ii)”.

1986—Subsec. (c)(3)(A). Pub. L. 99-514 substituted “for \$1,000,000 or less” for “for less than \$1,000,000” in heading of subsec. (c)(4)(A) as so designated prior to its redesignation as subsec. (c)(3)(A) by Pub. L. 99-121, §101(a)(1)(D), see 1985 Amendment note below.

1985—Subsec. (b)(2)(B). Pub. L. 99-121, §101(a)(1)(A), struck out “120 percent of” after “rate equal to”.

Subsec. (c)(1)(A)(ii). Pub. L. 99-121, §101(a)(1)(B), amended cl. (ii) generally, substituting “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(2). Pub. L. 99-121, §101(a)(1)(C), substituted “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(3). Pub. L. 99-121, §101(a)(1)(D), redesignated par. (4) as (3). Former par. (3), defining “testing amount”, was struck out.

Subsec. (c)(4). Pub. L. 99-121, §102(b), added par. (4). Former par. (4) redesignated (3).

Subsec. (d)(1)(B) to (D). Pub. L. 99-121, §101(b)(1), amended subpars. (B) to (D) generally, in subpar. (B) substituting provisions setting a monthly schedule for the determination of Federal rates for provisions which had formerly set a semi-annual schedule for the determination of such rates, in subpar. (C) substituting provisions setting a monthly schedule for the determination of Federal short-term, mid-term, and long-term rates based on the average market yield during any 1-month period ending in the month in which the determination is made for former provisions which had directed that the Federal rate determined under subpar. (A) apply during the appropriate 6-month period, and in subpar. (D) substituting provisions allowing a lower rate in certain cases for provisions relating to the setting of the Federal rate for any 6-month period.

Subsec. (d)(2). Pub. L. 99-121, §101(b)(2), amended par. (2) generally. Prior to amendment, par. (2) read as follows: “In the case of any sale or exchange, the determination of the applicable Federal rate shall be made as of the first day on which there is a binding contract in writing for the sale or exchange.”

Subsec. (e). Pub. L. 99-121, §101(c), added subsec. (e).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 applicable to returns the due date for which (determined without regard to extensions) is after Dec. 31, 1989, see section 7721(d) of Pub. L. 101-239, set out as a note under section 461 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1985 AMENDMENT

Pub. L. 99-121, title I, §105(a), Oct. 11, 1985, 99 Stat. 510, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by sections 101 and 102 [enacting section 1274A and amending this section and sections 280G and 483 of this title] shall apply to sales and exchanges after June 30, 1985, in taxable years ending after such date. The amendment made by section 2 of Public Law 98-612 [amending section 44(b) of Pub. L. 98-369, set out as a note under section 1271 of this title] shall not apply to sales and exchanges after June 30, 1985, in taxable years ending after such date.

“(2) REGULATORY AUTHORITY TO ESTABLISH LOWER RATE.—Section 1274(d)(1)(D) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], as added by section 101(b), shall apply as if included in the amendments made by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, see Effective Date note set out under section 1271 of this title].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to sales or exchanges after Dec. 31, 1984, but not applicable to any sale or exchange pursuant to a written contract which was binding on Mar. 1, 1984, and at all times thereafter before the sale or exchange, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE FOR PURPOSES OF IMPUTED
INTEREST RULES

Provisions respecting treatment of debt instruments received in exchange for property, relating to special rules for sales after Dec. 31, 1984, and before July 1, 1985, general rule for assumptions of loans, exception for assumptions of loans made on or before Oct. 15, 1984, and exception for assumptions of loans with respect to certain property, see section 44(b)(4)-(7) of Pub. L. 98-369, as amended, set out as an Effective Date note under section 1271 of this title.

§ 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000**(a) Lower discount rate**

In the case of any qualified debt instrument, the discount rate used for purposes of sections 483 and 1274 shall not exceed 9 percent, compounded semiannually.

(b) Qualified debt instrument defined

For purposes of this section, the term “qualified debt instrument” means any debt instrument given in consideration for the sale or exchange of property (other than new section 38 property within the meaning of section 48(b), as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of such instrument does not exceed \$2,800,000.

(c) Election to use cash method where stated principal amount does not exceed \$2,000,000**(1) In general**

In the case of any cash method debt instrument—

(A) section 1274 shall not apply, and

(B) interest on such debt instrument shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

(2) Cash method debt instrument

For purposes of paragraph (1), the term “cash method debt instrument” means any qualified debt instrument if—

(A) the stated principal amount does not exceed \$2,000,000,

(B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged,

(C) section 1274 would have applied to such instrument but for an election under this subsection, and

(D) an election under this subsection is jointly made with respect to such debt instrument by the borrower and lender.

(3) Successors bound by election**(A) In general**

Except as provided in subparagraph (B), paragraph (1) shall apply to any successor to the borrower or lender with respect to a cash method debt instrument.

(B) Exception where lender transfers debt instrument to accrual method taxpayer

If the lender (or any successor) transfers any cash method debt instrument to a taxpayer who uses an accrual method of accounting, this paragraph shall not apply with respect to such instrument for periods after such transfer.

(4) Fair market value rule in potentially abusive situations

In the case of any cash method debt instrument, section 483 shall be applied as if it included provisions similar to the provisions of section 1274(b)(3).

(d) Other special rules**(1) Aggregation rules**

For purposes of this section—

(A) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange, and

(B) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as 1 debt instrument.

(2) Adjustment for inflation

In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by an amount equal to—

(A) such amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting “calendar year 1988” for “calendar year 2016” in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of \$100 (or, if such increase is a multiple of \$50, such increase shall be increased to the nearest multiple of \$100).

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(1) regulations coordinating the provisions of this section with other provisions of this title,

(2) regulations necessary to prevent the avoidance of tax through the abuse of the provisions of subsection (c), and

(3) regulations relating to the treatment of transfers of cash method debt instruments.

(Added Pub. L. 99-121, title I, §102(a), Oct. 11, 1985, 99 Stat. 506; amended Pub. L. 101-508, title XI, §11813(b)(22), Nov. 5, 1990, 104 Stat. 1388-555; Pub. L. 104-188, title I, §1704(t)(62), Aug. 20, 1996, 110 Stat. 1890; Pub. L. 115-97, title I, §11002(d)(10), Dec. 22, 2017, 131 Stat. 2062.)

INFLATION ADJUSTED ITEMS FOR CERTAIN YEARS

For inflation adjustment of certain items in this section, see Revenue Rulings listed in a table below and Revenue Procedures listed in a table under section 1 of this title.

Editorial Notes**REFERENCES IN TEXT**

The date of the enactment of the Revenue Reconciliation Act of 1990, referred to in subsec. (b), is the date of enactment of Pub. L. 101-508, which was approved Nov. 5, 1990.

AMENDMENTS

2017—Subsec. (d)(2). Pub. L. 115-97 amended par. (2) generally. Prior to amendment, text read as follows:

“(A) IN GENERAL.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of \$100 (or, if such increase is a multiple of \$50, such increase shall be increased to the nearest multiple of \$100).

“(B) INFLATION ADJUSTMENT.—For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

“(i) the CPI for the preceding calendar year exceeds

“(ii) the CPI for calendar year 1988.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.”

1996—Subsec. (c)(1)(B). Pub. L. 104-188 substituted “instrument” for “instrument”.

1990—Subsec. (b). Pub. L. 101-508 inserted “, as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990” after “section 48(b)”.

Statutory Notes and Related Subsidiaries**EFFECTIVE DATE OF 2017 AMENDMENT**

Amendment by Pub. L. 115-97 applicable to taxable years beginning after Dec. 31, 2017, see section 11002(e) of Pub. L. 115-97, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE

Section applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

INFLATION ADJUSTED ITEMS FOR CERTAIN YEARS

Per Revenue Procedure 2018-57, after 2018, a separate Revenue Ruling relating to inflation-adjusted amounts under this section will not be published. Starting with 2019, see the table of Revenue Procedures set out under section 1 of this title. Provisions relating to inflation adjustment of items in this section for years before 2019 were contained in the following:

2018—Revenue Ruling 2018-11.
2017—Revenue Ruling 2016-30.
2016—Revenue Ruling 2015-24.
2015—Revenue Ruling 2014-30.
2014—Revenue Ruling 2013-23.
2013—Revenue Ruling 2012-33.
2012—Revenue Ruling 2011-27.
2011—Revenue Ruling 2010-30.
2010—Revenue Ruling 2010-2.
2009—Revenue Ruling 2008-52.
2008—Revenue Ruling 2008-3.
2007—Revenue Ruling 2007-4.
2006—Revenue Ruling 2005-76.
2005—Revenue Ruling 2004-107.
2004—Revenue Ruling 2003-119.
2003—Revenue Ruling 2002-79.
2002—Revenue Ruling 2001-65.
2001—Revenue Ruling 2000-55.
2000—Revenue Ruling 99-50.
1999—Revenue Ruling 98-58.
1998—Revenue Ruling 97-56.
1997—Revenue Ruling 96-63.
1996—Revenue Ruling 96-4.

§ 1275. Other definitions and special rules**(a) Definitions**

For purposes of this subpart—

(1) Debt instrument**(A) In general**

Except as provided in subparagraph (B), the term “debt instrument” means a bond, debenture, note, or certificate or other evidence of indebtedness.

(B) Exception for certain annuity contracts

The term “debt instrument” shall not include any annuity contract to which section 72 applies and which—

(i) depends (in whole or in substantial part) on the life expectancy of 1 or more individuals, or

(ii) is issued by an insurance company subject to tax under subchapter L (or by an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt)—

(I) in a transaction in which there is no consideration other than cash or another annuity contract meeting the requirements of this clause,

(II) pursuant to the exercise of an election under an insurance contract by a beneficiary thereof on the death of the insured party under such contract, or

(III) in a transaction involving a qualified pension or employee benefit plan.

(2) Issue date**(A) Publicly offered debt instruments**

In the case of any debt instrument which is publicly offered, the term “date of original issue” means the date on which the issue was first issued to the public.

(B) Issues not publicly offered and not issued for property

In the case of any debt instrument to which section 1273(b)(2) applies, the term “date of original issue” means the date on which the debt instrument was sold by the issuer.

(C) Other debt instruments

In the case of any debt instrument not described in subparagraph (A) or (B), the term “date of original issue” means the date on which the debt instrument was issued in a sale or exchange.

(3) Tax-exempt obligation

The term “tax-exempt obligation” means any obligation if—

(A) the interest on such obligation is not includible in gross income under section 103, or

(B) the interest on such obligation is exempt from tax (without regard to the identity of the holder) under any other provision of law.

(4) Treatment of obligations distributed by corporations

Any debt obligation of a corporation distributed by such corporation with respect to its stock shall be treated as if it had been issued by such corporation for property.

(b) Treatment of borrower in the case of certain loans for personal use**(1) Sections 1274 and 483 not to apply**

In the case of the obligor under any debt instrument given in consideration for the sale or exchange of property, sections 1274 and 483 shall not apply if such property is personal use property.

(2) Original issue discount deducted on cash basis in certain cases

In the case of any debt instrument, if—

(A) such instrument—

(i) is incurred in connection with the acquisition or carrying of personal use property, and

(ii) has original issue discount (determined after the application of paragraph (1)), and

(B) the obligor under such instrument uses the cash receipts and disbursements method of accounting,

notwithstanding section 163(e), the original issue discount on such instrument shall be deductible only when paid.

(3) Personal use property

For purposes of this subsection, the term “personal use property” means any property substantially all of the use of which by the taxpayer is not in connection with a trade or business of the taxpayer or an activity described in section 212. The determination of whether property is described in the preceding sentence shall be made as of the time of issuance of the debt instrument.

(c) Information requirements**(1) Information required to be set forth on instrument****(A) In general**

In the case of any debt instrument having original issue discount, the Secretary may by regulations require that—

(i) the amount of the original issue discount, and

(ii) the issue date,

be set forth on such instrument.

(B) Special rule for instruments not publicly offered

In the case of any issue of debt instruments not publicly offered, the regulations prescribed under subparagraph (A) shall not require the information to be set forth on the debt instrument before any disposition of such instrument by the first buyer.

(2) Information required to be submitted to Secretary

In the case of any issue of publicly offered debt instruments having original issue discount, the issuer shall (at such time and in such manner as the Secretary shall by regulation prescribe) furnish the Secretary the following information:

(A) The amount of the original issue discount.

(B) The issue date.

(C) Such other information with respect to the issue as the Secretary may by regulations require.

For purposes of the preceding sentence, any person who makes a public offering of stripped bonds (or stripped coupons) shall be treated as the issuer of a publicly offered debt instrument having original issue discount.

(3) Exceptions

This subsection shall not apply to any obligation referred to in section 1272(a)(2) (relating to exceptions from current inclusion of original issue discount).

(4) Cross reference

For civil penalty for failure to meet requirements of this subsection, see section 6706.

(d) Regulation authority

The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, or other circumstances, the tax treatment under this subpart (or section 163(e)) does not carry out the purposes of this subpart (or section 163(e)), such treatment shall be modified to the extent appropriate to carry out the purposes of this subpart (or section 163(e)).

(Added and amended Pub. L. 98-369, div. A, title I, §§41(a), 61(c)(2), July 18, 1984, 98 Stat. 540, 581; Pub. L. 99-514, title XVIII, §1804(f)(2)(A), Oct. 22, 1986, 100 Stat. 2805; Pub. L. 100-647, title I, §1006(u)(4), Nov. 10, 1988, 102 Stat. 3427; Pub. L. 101-508, title XI, §11325(a)(2), Nov. 5, 1990, 104 Stat. 1388-466; Pub. L. 106-554, §1(a)(7) [title III, §318(c)(1)], Dec. 21, 2000, 114 Stat. 2763, 2763A-645.)

Editorial Notes

AMENDMENTS

2000—Subsec. (a)(1)(B)(ii). Pub. L. 106-554, in introductory provisions, substituted “subchapter L (or by an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt)” for “subchapter L”.

1990—Subsec. (a)(4), (5). Pub. L. 101-508 redesignated par. (5) as (4) and struck out former par. (4) which related to a special rule for determination of issue price in case of exchange of debt instruments in reorganization.

1988—Subsec. (a)(4)(B)(ii)(I). Pub. L. 100-647 substituted “subsection (a)(7)” for “subsection (a)(6)”.

1986—Subsec. (a)(4), (5). Pub. L. 99-514 redesignated par. (4), relating to treatment of obligations distributed to corporations, as (5), and substituted “by corporations” for “to corporations” in heading.

1984—Subsec. (a)(4). Pub. L. 98-369, §61(c)(2), added par. (4) relating to treatment of obligations distributed to corporations.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2000 AMENDMENT

Pub. L. 106-554, §1(a)(7) [title III, §318(c)(2)], Dec. 21, 2000, 114 Stat. 2763, 2763A-645, provided that: “The amendment made by this subsection [amending this section] shall take effect as if included in the amendments made by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, div. A].”

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 applicable, with certain exceptions, to debt instruments issued and stock transferred after Oct. 1, 1990, in satisfaction of any in-

debtedness, see section 11325(c) of Pub. L. 101-508, set out as a note under section 108 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable with respect to distributions declared Mar. 15, 1984, in taxable years ending after that date, see section 61(e)(3) of Pub. L. 98-369, set out as a note under section 312 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, but subsec. (c) of this section effective on the day 30 days after July 18, 1984, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

**PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989**

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART B—MARKET DISCOUNT ON BONDS

Sec.

- | | |
|-------|---|
| 1276. | Disposition gain representing accrued market discount treated as ordinary income. |
| 1277. | Deferral of interest deduction allocable to accrued market discount. |
| 1278. | Definitions and special rules. |

§ 1276. Disposition gain representing accrued market discount treated as ordinary income

(a) Ordinary income

(1) In general

Except as otherwise provided in this section, gain on the disposition of any market discount bond shall be treated as ordinary income to the extent it does not exceed the accrued market discount on such bond. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Dispositions other than sales, etc.

For purposes of paragraph (1), a person disposing of any market discount bond in any transaction other than a sale, exchange, or involuntary conversion shall be treated as realizing an amount equal to the fair market value of the bond.

(3) Treatment of partial principal payments

(A) In general

Any partial principal payment on a market discount bond shall be included in gross income as ordinary income to the extent such payment does not exceed the accrued market discount on such bond.

(B) Adjustment

If subparagraph (A) applies to any partial principal payment on any market discount bond, for purposes of applying this section to any disposition of (or subsequent partial principal payment on) such bond, the amount of accrued market discount shall be reduced by the amount of such partial principal payment included in gross income under subparagraph (A).

(4) Gain treated as interest for certain purposes

Except for purposes of sections 103, 871(a), 881, 1441, 1442, and 6049 (and such other provisions as may be specified in regulations), any amount treated as ordinary income under paragraph (1) or (3) shall be treated as interest for purposes of this title.

(b) Accrued market discount

For purposes of this section—

(1) Ratable accrual

Except as otherwise provided in this subsection or subsection (c), the accrued market discount on any bond shall be an amount which bears the same ratio to the market discount on such bond as—

(A) the number of days which the taxpayer held the bond, bears to

(B) the number of days after the date the taxpayer acquired the bond and up to (and including) the date of its maturity.

(2) Election of accrual on basis of constant interest rate (in lieu of ratable accrual)**(A) In general**

At the election of the taxpayer with respect to any bond, the accrued market discount on such bond shall be the aggregate amount which would have been includible in the gross income of the taxpayer under section 1272(a) (determined without regard to paragraph (2) thereof) with respect to such bond for all periods during which the bond was held by the taxpayer if such bond had been—

(i) originally issued on the date on which such bond was acquired by the taxpayer,

(ii) for an issue price equal to the basis of the taxpayer in such bond immediately after its acquisition.

(B) Coordination where bond has original issue discount

In the case of any bond having original issue discount, for purposes of applying subparagraph (A)—

(i) the stated redemption price at maturity of such bond shall be treated as equal to its revised issue price, and

(ii) the determination of the portion of the original issue discount which would have been includible in the gross income of the taxpayer under section 1272(a) shall be made under regulations prescribed by the Secretary.

(C) Election irrevocable

An election under subparagraph (A), once made with respect to any bond, shall be irrevocable.

(3) Special rule where partial principal payments

In the case of a bond the principal of which may be paid in 2 or more payments, the amount of accrued market discount shall be determined under regulations prescribed by the Secretary.

(c) Treatment of nonrecognition transactions

Under regulations prescribed by the Secretary—

(1) Transferred basis property

If a market discount bond is transferred in a nonrecognition transaction and such bond is transferred basis property in the hands of the transferee, for purposes of determining the amount of the accrued market discount with respect to the transferee—

(A) the transferee shall be treated as having acquired the bond on the date on which it was acquired by the transferor for an amount equal to the basis of the transferor, and

(B) proper adjustments shall be made for gain recognized by the transferor on such transfer (and for any original issue discount or market discount included in the gross income of the transferor).

(2) Exchanged basis property

If any market discount bond is disposed of by the taxpayer in a nonrecognition transaction and paragraph (1) does not apply to such transaction, any accrued market discount determined with respect to the property disposed of to the extent not theretofore treated as ordinary income under subsection (a)—

(A) shall be treated as accrued market discount with respect to the exchanged basis property received by the taxpayer in such transaction if such property is a market discount bond, and

(B) shall be treated as ordinary income on the disposition of the exchanged basis property received by the taxpayer in such exchange if such property is not a market discount bond.

(3) Paragraph (1) to apply to certain distributions by corporations or partnerships

For purposes of paragraph (1), if the basis of any market discount bond in the hands of a transferee is determined under section 732(a), or 732(b), such property shall be treated as transferred basis property in the hands of such transferee.

(d) Special rules

Under regulations prescribed by the Secretary—

(1) rules similar to the rules of subsection (b) of section 1245 shall apply for purposes of this section; except that—

(A) paragraph (1) of such subsection shall not apply,

(B) an exchange qualifying under section 354(a), 355(a), or 356(a) (determined without regard to subsection (a) of this section) shall be treated as an exchange described in paragraph (3) of such subsection, and

(C) paragraph (3) of section 1245(b) shall be applied as if it did not contain a reference to section 351, and

(2) appropriate adjustments shall be made to the basis of any property to reflect gain recognized under subsection (a).

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 543; amended Pub. L. 99-514, title VI, § 631(e)(15), title XVIII, §§ 1803(a)(5), (13)(A), 1899A(28), Oct. 22, 1986, 100 Stat. 2275, 2793, 2796, 2960; Pub. L. 100-647, title I, § 1018(u)(46), Nov. 10, 1988, 102 Stat. 3592; Pub. L. 103-66, title XIII, § 13206(b)(1)(A), (2)(B)(i), Aug. 10, 1993, 107 Stat. 465; Pub. L. 115-141, div. U, title IV, § 401(a)(180), Mar. 23, 2018, 132 Stat. 1193.)

Editorial Notes

AMENDMENTS

2018—Subsec. (a)(4). Pub. L. 115-141 substituted “871(a),” for “871(a),”.

1993—Subsec. (a)(4). Pub. L. 103-66, § 13206(b)(2)(B)(i), substituted “sections 103, 871(a),” for “sections 871(a).”

Subsec. (e). Pub. L. 103-66, § 13206(b)(1)(A), struck out heading and text of subsec. (e). Text read as follows: “This section shall not apply to any market discount bond issued on or before July 18, 1984.”

1988—Subsec. (b)(3). Pub. L. 100-647 designated paragraph relating to special rule where there are partial principal payments as par. (3) and inserted period at end.

1986—Subsec. (a)(3). Pub. L. 99-514, § 1803(a)(13)(A)(i), added par. (3). Former par. (3) redesignated (4).

Subsec. (a)(4). Pub. L. 99-514, § 1803(a)(13)(A)(i), (ii), redesignated par. (3) as (4) and substituted “under paragraph (1) or (3)” for “under paragraph (1).”

Subsec. (b). Pub. L. 99-514, § 1803(a)(13)(A)(iii), added undesignated par. at end relating to special rule where partial principal payments.

Subsec. (c)(3). Pub. L. 99-514, § 631(e)(15), struck out reference to section 334(c).

Subsec. (d)(1)(C). Pub. L. 99-514, § 1803(a)(5), added subpar. (C).

Subsec. (e). Pub. L. 99-514, § 1899A(28), substituted “July 18, 1984” for “the date of the enactment of this section”.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1993 AMENDMENT

Pub. L. 103-66, title XIII, § 13206(b)(3), Aug. 10, 1993, 107 Stat. 465, provided that: “The amendments made by this section [probably should be “subsection”, which amended this section and sections 1277 and 1278 of this title] shall apply to obligations purchased (within the meaning of section 1272(d)(1) of the Internal Revenue Code of 1986) after April 30, 1993.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 631(e)(15) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

Amendment by section 1803(a)(5) of Pub. L. 99-514 effective, except as otherwise provided, as if included in

the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Pub. L. 99-514, title XVIII, § 1803(a)(13)(C), Oct. 22, 1986, 100 Stat. 2797, provided that: “The amendments made by this paragraph [amending this section and section 1286 of this title] shall apply to obligations acquired after the date of the enactment of this Act [Oct. 22, 1986].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations issued after July 18, 1984, in taxable years ending after such date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1277. Deferral of interest deduction allocable to accrued market discount

(a) General rule

Except as otherwise provided in this section, the net direct interest expense with respect to any market discount bond shall be allowed as a deduction for the taxable year only to the extent that such expense exceeds the portion of the market discount allocable to the days during the taxable year on which such bond was held by the taxpayer (as determined under the rules of section 1276(b)).

(b) Disallowed deduction allowed for later years

(1) Election to take into account in later year where net interest income from bond

(A) In general

If—

(i) there is net interest income for any taxable year with respect to any market discount bond, and

(ii) the taxpayer makes an election under this subparagraph with respect to such bond,

any disallowed interest expense with respect to such bond shall be treated as interest paid or accrued by the taxpayer during such taxable year to the extent such disallowed interest expense does not exceed the net interest income with respect to such bond.

(B) Determination of disallowed interest expense

For purposes of subparagraph (A), the amount of the disallowed interest expense—

(i) shall be determined as of the close of the preceding taxable year, and

(ii) shall not include any amount previously taken into account under subparagraph (A).

(C) Net interest income

For purposes of this paragraph, the term “net interest income” means the excess of

the amount determined under paragraph (2) of subsection (c) over the amount determined under paragraph (1) of subsection (c).

(2) Remainder of disallowed interest expense allowed for year of disposition

(A) In general

Except as otherwise provided in this paragraph, the amount of the disallowed interest expense with respect to any market discount bond shall be treated as interest paid or accrued by the taxpayer in the taxable year in which such bond is disposed of.

(B) Nonrecognition transactions

If any market discount bond is disposed of in a nonrecognition transaction—

- (i) the disallowed interest expense with respect to such bond shall be treated as interest paid or accrued in the year of disposition only to the extent of the amount of gain recognized on such disposition, and
- (ii) the disallowed interest expense with respect to such property (to the extent not so treated) shall be treated as disallowed interest expense—

(I) in the case of a transaction described in section 1276(c)(1), of the transferee with respect to the transferred basis property, or

(II) in the case of a transaction described in section 1276(c)(2), with respect to the exchanged basis property.

(C) Disallowed interest expense reduced for amounts previously taken into account under paragraph (1)

For purposes of this paragraph, the amount of the disallowed interest expense shall not include any amount previously taken into account under paragraph (1).

(3) Disallowed interest expense

For purposes of this subsection, the term “disallowed interest expense” means the aggregate amount disallowed under subsection (a) with respect to the market discount bond.

(c) Net direct interest expense

For purposes of this section, the term “net direct interest expense” means, with respect to any market discount bond, the excess (if any) of—

- (1) the amount of interest paid or accrued during the taxable year on indebtedness which is incurred or continued to purchase or carry such bond, over
- (2) the aggregate amount of interest (including original issue discount) includible in gross income for the taxable year with respect to such bond.

In the case of any financial institution which is a bank (as defined in section 585(a)(2)), the determination of whether interest is described in paragraph (1) shall be made under principles similar to the principles of section 291(e)(1)(B)(ii). Under rules similar to the rules of section 265(a)(5), short sale expenses shall be treated as interest for purposes of determining net direct interest expense.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 545; amended Pub. L. 99-514,

title IX, §§901(d)(4)(F), §902(e)(2), title XVIII, §1899A(29)-(31), Oct. 22, 1986, 100 Stat. 2380, 2382, 2960; Pub. L. 100-647, title I, §1018(u)(31), Nov. 10, 1988, 102 Stat. 3592; Pub. L. 103-66, title XIII, §13206(b)(1)(B), Aug. 10, 1993, 107 Stat. 465; Pub. L. 104-188, title I, §1616(b)(14), Aug. 20, 1996, 110 Stat. 1857.)

Editorial Notes

AMENDMENTS

1996—Subsec. (c). Pub. L. 104-188 struck out “or to which section 593 applies” after “585(a)(2)” in closing provisions.

1993—Subsec. (d). Pub. L. 103-66 struck out heading and text of subsec. (d). Text read as follows: “In the case of a market discount bond issued on or before July 18, 1984, any gain recognized by the taxpayer on any disposition of such bond shall be treated as ordinary income to the extent the amount of such gain does not exceed the amount allowable with respect to such bond under subsection (b)(2) for the taxable year in which such bond is disposed of.”

1988—Subsec. (c). Pub. L. 100-647 inserted a closing parenthesis after “section 585(a)(2)”.

1986—Subsec. (b)(1)(C). Pub. L. 99-514, §1899A(29), substituted “this paragraph” for “this paragraph”.

Subsec. (b)(2)(C). Pub. L. 99-514, §1899A(30), substituted “paragraph (1)” for “paragraph 1” in heading.

Subsec. (c). Pub. L. 99-514, §901(d)(4)(F), substituted “which is a bank (as defined in section 585(a)(2) or to which section 593 applies” for “to which section 585 or 593 applies”.

Pub. L. 99-514, §902(e)(2), substituted “section 265(a)(5)” for “section 265(5)”.

Subsec. (d). Pub. L. 99-514, §1899A(31), substituted “July 18, 1984” for “the date of the enactment of this section”.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1995, see section 1616(c) of Pub. L. 104-188, set out as a note under section 593 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to obligations purchased (within the meaning of section 1272(d)(1) [now 1272(c)(1)] of this title) after Apr. 30, 1993, see section 13206(b)(3) of Pub. L. 103-66, set out as a note under section 1276 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 901(d)(4)(F) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 901(e) of Pub. L. 99-514, set out as a note under section 166 of this title.

Amendment by section 902(e)(2) of Pub. L. 99-514 applicable to taxable years ending after Dec. 31, 1986, with certain exceptions and qualifications, see section 902(f) of Pub. L. 99-514, set out as a note under section 265 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations acquired after July 18, 1984, in taxable years ending after such date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1278. Definitions and special rules

(a) In general

For purposes of this part—

(1) Market discount bond

(A) In general

Except as provided in subparagraph (B), the term “market discount bond” means any bond having market discount.

(B) Exceptions

The term “market discount bond” shall not include—

(i) Short-term obligations

Any obligation with a fixed maturity date not exceeding 1 year from the date of issue.

(ii) United States savings bonds

Any United States savings bond.

(iii) Installment obligations

Any installment obligation to which section 453B applies.

(C) Section 1277 not applicable to tax-exempt obligations

For purposes of section 1277, the term “market discount bond” shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

(D) Treatment of bonds acquired at original issue

(i) In general

Except as otherwise provided in this subparagraph or in regulations, the term “market discount bond” shall not include any bond acquired by the taxpayer at its original issue.

(ii) Treatment of bonds acquired for less than issue price

Clause (i) shall not apply to any bond if—

(I) the basis of the taxpayer in such bond is determined under section 1012, and

(II) such basis is less than the issue price of such bond determined under subpart A of this part.

(iii) Bonds acquired in certain reorganizations

Clause (i) shall not apply to any bond issued pursuant to a plan of reorganization (within the meaning of section 368(a)(1)) in exchange for another bond having market discount. Solely for purposes of section 1276, the preceding sentence shall not apply if such other bond was issued on or

before July 18, 1984 (the date of the enactment of section 1276) and if the bond issued pursuant to such plan of reorganization has the same term and the same interest rate as such other bond had.

(iv) Treatment of certain transferred basis property

For purposes of clause (i), if the adjusted basis of any bond in the hands of the taxpayer is determined by reference to the adjusted basis of such bond in the hands of a person who acquired such bond at its original issue, such bond shall be treated as acquired by the taxpayer at its original issue.

(2) Market discount

(A) In general

The term “market discount” means the excess (if any) of—

(i) the stated redemption price of the bond at maturity, over

(ii) the basis of such bond immediately after its acquisition by the taxpayer.

(B) Coordination where bond has original issue discount

In the case of any bond having original issue discount, for purposes of subparagraph (A), the stated redemption price of such bond at maturity shall be treated as equal to its revised issue price.

(C) De minimis rule

If the market discount is less than $\frac{1}{4}$ of 1 percent of the stated redemption price of the bond at maturity multiplied by the number of complete years to maturity (after the taxpayer acquired the bond), then the market discount shall be considered to be zero.

(3) Bond

The term “bond” means any bond, debenture, note, certificate, or other evidence of indebtedness.

(4) Revised issue price

The term “revised issue price” means the sum of—

(A) the issue price of the bond, and

(B) the aggregate amount of the original issue discount includible in the gross income of all holders for periods before the acquisition of the bond by the taxpayer (determined without regard to section 1272(a)(7)) or, in the case of a tax-exempt obligation, the aggregate amount of the original issue discount which accrued in the manner provided by section 1272(a) (determined without regard to paragraph (7) thereof) during periods before the acquisition of the bond by the taxpayer.

(5) Original issue discount, etc.

The terms “original issue discount”, “stated redemption price at maturity”, and “issue price” have the respective meanings given such terms by subpart A of this part.

(b) Election to include market discount currently

(1) In general

If the taxpayer makes an election under this subsection—

(A) sections 1276 and 1277 shall not apply, and

(B) market discount on any market discount bond shall be included in the gross income of the taxpayer for the taxable years to which it is attributable (as determined under the rules of subsection (b) of section 1276).

Except for purposes of sections 103, 871(a), 881, 1441, 1442, and 6049 (and such other provisions as may be specified in regulations), any amount included in gross income under subparagraph (B) shall be treated as interest for purposes of this title.

(2) Scope of election

An election under this subsection shall apply to all market discount bonds acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

(3) Period to which election applies

An election under this subsection shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(4) Basis adjustment

The basis of any bond in the hands of the taxpayer shall be increased by the amount included in gross income pursuant to this subsection.

(c) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subpart, including regulations providing proper adjustments in the case of a bond the principal of which may be paid in 2 or more payments.

(Added and amended Pub. L. 98-369, div. A, title I, §41(a), title X, §1001(b)(24), July 18, 1984, 98 Stat. 547; Pub. L. 99-514, title XVIII, §§1803(a)(6), 1878(a), 1899A(32), Oct. 22, 1986, 100 Stat. 2793, 2903, 2960; Pub. L. 100-647, title I, §§1006(u)(2), 1018(c)(2), (3), Nov. 10, 1988, 102 Stat. 3427, 3578; Pub. L. 103-66, title XIII, §13206(b)(2), Aug. 10, 1993, 107 Stat. 465; Pub. L. 115-141, div. U, title IV, §401(a)(181), (c)(1)(G), Mar. 23, 2018, 132 Stat. 1193, 1205.)

Editorial Notes

AMENDMENTS

2018—Subsec. (a)(4)(B). Pub. L. 115-141, §401(c)(1)(G), struck out “or (b)(4)” after “1272(a)(7)”.

Subsec. (b)(1). Pub. L. 115-141, §401(a)(181), substituted “871(a),” for “871(a),” in concluding provisions.

1993—Subsec. (a)(1)(B)(ii)–(iv). Pub. L. 103-66, §13206(b)(2)(A)(i), redesignated cls. (iii) and (iv) as (ii) and (iii), respectively, and struck out heading and text of former cl. (ii). Text read as follows: “Any tax-exempt obligation (as defined in section 1275(a)(3)).”

Subsec. (a)(1)(C), (D). Pub. L. 103-66, §13206(b)(2)(A)(ii), (iii), added subpar. (C) and redesignated former subpar. (C) as (D).

Subsec. (a)(4)(B). Pub. L. 103-66, §13206(b)(2)(B)(ii), inserted before period at end “or, in the case of a tax-exempt obligation, the aggregate amount of the original issue discount which accrued in the manner provided by section 1272(a) (determined without regard to para-

graph (7) thereof) during periods before the acquisition of the bond by the taxpayer”.

Subsec. (b)(1). Pub. L. 103-66, §13206(b)(2)(B)(i), substituted “sections 103, 871(a),” for “sections 871(a)” in last sentence.

1988—Subsec. (a)(4)(B). Pub. L. 100-647, §1006(u)(2), substituted “section 1272(a)(7)” for “section 1272(a)(6)”.

Subsec. (b)(4). Pub. L. 100-647, §1018(c)(3), added par. (4).

Subsec. (c). Pub. L. 100-647, §1018(c)(2), inserted before period at end “, including regulations providing proper adjustments in the case of a bond the principal of which may be paid in 2 or more payments”.

1986—Subsec. (a)(1)(B)(i). Pub. L. 99-514, §1878(a), amended Pub. L. 98-369, §1001(b), by adding a par. (24), effective as if included in Pub. L. 98-369. See 1984 Amendment note below.

Subsec. (a)(1)(C). Pub. L. 99-514, §1803(a)(6), added subpar. (C).

Subsec. (a)(4). Pub. L. 99-514, §1899A(32), substituted “means” for “means of” in introductory provisions.

1984—Subsec. (a)(1)(B)(i). Pub. L. 98-369, §1001(b)(24), as added by Pub. L. 99-514, §1878(a), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2018 AMENDMENT

Amendment by section 401(c)(1)(G) of Pub. L. 115-141 applicable to debt instruments issued on or after July 2, 1982, see section 401(c)(1)(H) of Pub. L. 115-141, set out as a note under section 163 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendments by Pub. L. 103-66 applicable to obligations purchased (within the meaning of section 1272(d)(1) of this title) after Apr. 30, 1993, see section 13206(b)(3) of Pub. L. 103-66, set out as a note under section 1276 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by sections 1803(a)(6) and 1878(a) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART C—DISCOUNT ON SHORT-TERM
OBLIGATIONS

Sec.	
1281.	Current inclusion in income of discount on certain short-term obligations.
1282.	Deferral of interest deduction allocable to accrued discount.
1283.	Definitions and special rules.

§ 1281. Current inclusion in income of discount on certain short-term obligations

(a) General rule

In the case of any short-term obligation to which this section applies, for purposes of this title—

- (1) there shall be included in the gross income of the holder an amount equal to the sum of the daily portions of the acquisition discount for each day during the taxable year on which such holder held such obligation, and
- (2) any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) shall be included in gross income as it accrues.

(b) Short-term obligations to which section applies

(1) In general

This section shall apply to any short-term obligation which—

- (A) is held by a taxpayer using an accrual method of accounting,
- (B) is held primarily for sale to customers in the ordinary course of the taxpayer's trade or business,
- (C) is held by a bank (as defined in section 581),
- (D) is held by a regulated investment company or a common trust fund,
- (E) is identified by the taxpayer under section 1256(e)(2) as being part of a hedging transaction, or
- (F) is a stripped bond or stripped coupon held by the person who stripped the bond or coupon (or by any other person whose basis is determined by reference to the basis in the hands of such person).

(2) Treatment of obligations held by pass-thru entities

(A) In general

This section shall apply also to—

- (i) any short-term obligation which is held by a pass-thru entity which is formed or availed of for purposes of avoiding the provisions of this section, and
- (ii) any short-term obligation which is acquired by a pass-thru entity (not described in clause (i)) during the required accrual period.

(B) Required accrual period

For purposes of subparagraph (A), the term "required accrual period" means the period—

- (i) which begins with the first taxable year for which the ownership test of subparagraph (C) is met with respect to the pass-thru entity (or a predecessor), and
- (ii) which ends with the first taxable year after the taxable year referred to in

clause (i) for which the ownership test of subparagraph (C) is not met and with respect to which the Secretary consents to the termination of the required accrual period.

(C) Ownership test

The ownership test of this subparagraph is met for any taxable year if, on at least 90 days during the taxable year, 20 percent or more of the value of the interests in the pass-thru entity are held by persons described in paragraph (1) or by other pass-thru entities to which subparagraph (A) applies.

(D) Pass-thru entity

The term "pass-thru entity" means any partnership, S corporation, trust, or other pass-thru entity.

(c) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 548; amended Pub. L. 99-514, title XVIII, §1803(a)(7), (8)(A), Oct. 22, 1986, 100 Stat. 2793, 2794.)

Editorial Notes

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514, §1803(a)(8), amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

Subsec. (b)(1)(F). Pub. L. 99-514, §1803(a)(7), added subpar. (F).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1803(a)(7) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Section 1803(a)(8)(A) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1018(c)(1), Nov. 10, 1988, 102 Stat. 3578, provided that the amendment made by section 1803(a)(8)(A) of Pub. L. 99-514 is effective with respect to obligations acquired after Dec. 31, 1985.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations acquired after that date, with certain elections available, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1282. Deferral of interest deduction allocable to accrued discount

(a) General rule

Except as otherwise provided in this section, the net direct interest expense with respect to

any short-term obligation shall be allowed as a deduction for the taxable year only to the extent such expense exceeds the sum of—

(1) the daily portions of the acquisition discount for each day during the taxable year on which the taxpayer held such obligation, and

(2) the amount of any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) which accrues during the taxable year while the taxpayer held such obligation (and is not included in the gross income of the taxpayer for such taxable year by reason of the taxpayer's method of accounting).

(b) Section not to apply to obligations to which section 1281 applies

(1) In general

This section shall not apply to any short-term obligation to which section 1281 applies.

(2) Election to have section 1281 apply to all obligations

(A) In general

A taxpayer may make an election under this paragraph to have section 1281 apply to all short-term obligations acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

(B) Period to which election applies

An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(c) Certain rules made applicable

Rules similar to the rules of subsections (b) and (c) of section 1277 shall apply for purposes of this section.

(d) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 549; amended Pub. L. 99-514, title XVIII, §1803(a)(8)(B), Oct. 22, 1986, 100 Stat. 2794.)

Editorial Notes

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514 amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and to obligations acquired after that date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1283. Definitions and special rules

(a) Definitions

For purposes of this subpart—

(1) Short-term obligation

(A) In general

Except as provided in subparagraph (B), the term “short-term obligation” means any bond, debenture, note, certificate, or other evidence of indebtedness which has a fixed maturity date not more than 1 year from the date of issue.

(B) Exceptions for tax-exempt obligations

The term “short-term obligation” shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

(2) Acquisition discount

The term “acquisition discount” means the excess of—

(A) the stated redemption price at maturity (as defined in section 1273), over

(B) the taxpayer's basis for the obligation.

(b) Daily portion

For purposes of this subpart—

(1) Ratable accrual

Except as otherwise provided in this subsection, the daily portion of the acquisition discount is an amount equal to—

(A) the amount of such discount, divided by

(B) the number of days after the day on which the taxpayer acquired the obligation and up to (and including) the day of its maturity.

(2) Election of accrual on basis of constant interest rate (in lieu of ratable accrual)

(A) In general

At the election of the taxpayer with respect to any obligation, the daily portion of the acquisition discount for any day is the portion of the acquisition discount accruing on such day determined (under regulations prescribed by the Secretary) on the basis of—

(i) the taxpayer's yield to maturity based on the taxpayer's cost of acquiring the obligation, and

(ii) compounding daily.

(B) Election irrevocable

An election under subparagraph (A), once made with respect to any obligation, shall be irrevocable.

(c) Special rules for nongovernmental obligations

(1) In general

In the case of any short-term obligation which is not a short-term Government obligation (as defined in section 1271(a)(3)(B))—

(A) sections 1281 and 1282 shall be applied by taking into account original issue discount in lieu of acquisition discount, and

(B) appropriate adjustments shall be made in the application of subsection (b) of this section.

(2) Election to have paragraph (1) not apply

(A) In general

A taxpayer may make an election under this paragraph to have paragraph (1) not apply to all obligations acquired by the taxpayer on or after the first day of the first taxable year to which such election applies.

(B) Period to which election applies

An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(d) Other special rules

(1) Basis adjustments

The basis of any short-term obligation in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to section 1281.

(2) Double inclusion in income not required

Section 1281 shall not require the inclusion of any amount previously includible in gross income.

(3) Coordination with other provisions

Section 454(b) and paragraphs (3) and (4) of section 1271(a) shall not apply to any short-term obligation to which section 1281 applies.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 549; amended Pub. L. 99-514, title XVIII, §1803(a)(1)(B), Oct. 22, 1986, 100 Stat. 2792.)

Editorial Notes

AMENDMENTS

1986—Subsec. (d)(3). Pub. L. 99-514 substituted “paragraphs (3) and (4) of section 1271(a)” for “section 1271(a)(3)”.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and to obligations acquired after that date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see

section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART D—MISCELLANEOUS PROVISIONS

Sec.

1286.	Tax treatment of stripped bonds.
1287.	Denial of capital gain treatment for gains on certain obligations not in registered form.
1288.	Treatment of original issue discount on tax-exempt obligations.

§ 1286. Tax treatment of stripped bonds

(a) Inclusion in income as if bond and coupons were original issue discount bonds

If any person purchases a stripped bond or a stripped coupon, then such bond or coupon while held by such purchaser (or by any other person whose basis is determined by reference to the basis in the hands of such purchaser) shall be treated for purposes of this part as a bond originally issued on the purchase date and having an original issue discount equal to the excess (if any) of—

(1) the stated redemption price at maturity (or, in the case of coupon, the amount payable on the due date of such coupon), over

(2) such bond's or coupon's ratable share of the purchase price.

For purposes of paragraph (2), ratable shares shall be determined on the basis of their respective fair market values on the date of purchase.

(b) Tax treatment of person stripping bond

For purposes of this subtitle, if any person strips 1 or more coupons from a bond and disposes of the bond or such coupon—

(1) such person shall include in gross income an amount equal to the sum of—

(A) the interest accrued on such bond while held by such person and before the time such coupon or bond was disposed of (to the extent such interest has not theretofore been included in such person's gross income), and

(B) the accrued market discount on such bond determined as of the time such coupon or bond was disposed of (to the extent such discount has not theretofore been included in such person's gross income),

(2) the basis of the bond and coupons shall be increased by the amount included in gross income under paragraph (1),

(3) the basis of the bond and coupons immediately before the disposition (as adjusted pursuant to paragraph (2)) shall be allocated among the items retained by such person and the items disposed of by such person on the basis of their respective fair market values, and

(4) for purposes of subsection (a), such person shall be treated as having purchased on the date of such disposition each such item which he retains for an amount equal to the basis allocated to such item under paragraph (3).

A rule similar to the rule of paragraph (4) shall apply in the case of any person whose basis in any bond or coupon is determined by reference to the basis of the person described in the preceding sentence.

(c) Special rules for tax-exempt obligations**(1) In general**

In the case of any tax-exempt obligation (as defined in section 1275(a)(3)) from which 1 or more coupons have been stripped—

(A) the amount of the original issue discount determined under subsection (a) with respect to any stripped bond or stripped coupon—

(i) shall be treated as original issue discount on a tax-exempt obligation to the extent such discount does not exceed the tax-exempt portion of such discount, and

(ii) shall be treated as original issue discount on an obligation which is not a tax-exempt obligation to the extent such discount exceeds the tax-exempt portion of such discount,

(B) subsection (b)(1)(A) shall not apply, and

(C) subsection (b)(2) shall be applied by increasing the basis of the bond or coupon by the sum of—

(i) the interest accrued but not paid before such bond or coupon was disposed of (and not previously reflected in basis), plus

(ii) the amount included in gross income under subsection (b)(1)(B).

(2) Tax-exempt portion

For purposes of paragraph (1), the tax-exempt portion of the original issue discount determined under subsection (a) is the excess of—

(A) the amount referred to in subsection (a)(1), over

(B) an issue price which would produce a yield to maturity as of the purchase date equal to the lower of—

(i) the coupon rate of interest on the obligation from which the coupons were separated, or

(ii) the yield to maturity (on the basis of the purchase price) of the stripped obligation or coupon.

The purchaser of any stripped obligation or coupon may elect to apply clause (i) by substituting “original yield to maturity of” for “coupon rate of interest on”.

(d) Definitions and special rules

For purposes of this section—

(1) Bond

The term “bond” means a bond, debenture, note, or certificate or other evidence of indebtedness.

(2) Stripped bond

The term “stripped bond” means a bond issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable.

(3) Stripped coupon

The term “stripped coupon” means any coupon relating to a stripped bond.

(4) Stated redemption price at maturity

The term “stated redemption price at maturity” has the meaning given such term by section 1273(a)(2).

(5) Coupon

The term “coupon” includes any right to receive interest on a bond (whether or not evidenced by a coupon).

(6) Purchase

The term “purchase” has the meaning given such term by section 1272(d)(1).¹

(e) Treatment of stripped interests in bond and preferred stock funds, etc.

In the case of an account or entity substantially all of the assets of which consist of bonds, preferred stock, or a combination thereof, the Secretary may by regulations provide that rules similar to the rules of this section and section 305(e), as appropriate, shall apply to interests in such account or entity to which (but for this subsection) this section or section 305(e), as the case may be, would not apply.

(f) Regulation authority

The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, or other circumstances, the tax treatment under this section does not accurately reflect the income of the holder of a stripped coupon or stripped bond, or of the person disposing of such bond or coupon, as the case may be, for any period, such treatment shall be modified to require that the proper amount of income be included for such period.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 551; amended Pub. L. 99-514, title XVIII, §§1803(a)(13)(B), 1879(s)(1), Oct. 22, 1986, 100 Stat. 2796, 2912; Pub. L. 100-647, title I, §1018(q)(4)(A), Nov. 10, 1988, 102 Stat. 3585; Pub. L. 108-357, title VIII, §831(a), Oct. 22, 2004, 118 Stat. 1587; Pub. L. 115-141, div. U, title IV, §401(a)(182), (c)(2)(A)–(C), Mar. 23, 2018, 132 Stat. 1193, 1205, 1206.)

Editorial Notes

REFERENCES IN TEXT

Section 1272(d), referred to in subsec. (d)(6), was redesignated section 1272(c) by Pub. L. 115-141, div. U, title IV, §401(c)(1)(B), Mar. 23, 2018, 132 Stat. 1205.

AMENDMENTS

2018—Subsec. (a). Pub. L. 115-141, §401(c)(2)(B), struck out “after July 1, 1982,” before “a stripped bond” in introductory provisions.

Subsec. (b). Pub. L. 115-141, §401(c)(2)(B), struck out “after July 1, 1982,” before “disposes of the bond” in introductory provisions.

Subsec. (c). Pub. L. 115-141, §401(c)(2)(A), redesignated subsec. (d) as (c) and struck out former subsec. (c) which related to retention of existing law for stripped bonds purchased before July 2, 1982.

Subsec. (d). Pub. L. 115-141, §401(c)(2)(A), redesignated subsec. (e) as (d). Former subsec. (d) redesignated (c).

Subsec. (d)(5). Pub. L. 115-141, §401(c)(2)(C), struck out at end “This paragraph shall apply for purposes of subsection (c) only in the case of purchases after July 1, 1982.”

Subsec. (e). Pub. L. 115-141, §401(c)(2)(A), redesignated subsec. (f) as (e). Former subsec. (e) redesignated (d).

Subsec. (f). Pub. L. 115-141, §401(c)(2)(A), redesignated subsec. (g) as (f). Former subsec. (f) redesignated (e).

Pub. L. 115-141, §401(a)(182), substituted “and section 305(e),” for “and 305(e),”.

¹ See References in Text note below.

Subsec. (g). Pub. L. 115-141, § 401(c)(2)(A), redesignated subsec. (g) as (f).

2004—Subsecs. (f), (g). Pub. L. 108-357 added subsec. (f) and redesignated former subsec. (f) as (g).

1988—Subsec. (d). Pub. L. 100-647 amended subsec. (d) generally. Prior to amendment, subsec. (d) read as follows: “In the case of any tax-exempt obligation (as defined in section 1275(a)(3)) from which 1 or more coupons have been stripped—

“(1) the amount of original issue discount determined under subsection (a) with respect to any stripped bond or stripped coupon from such obligation shall be the amount which produces a yield to maturity (as of the purchase date) equal to the lower of—

“(A) the coupon rate of interest on such obligation before the separation of coupons, or

“(B) the yield to maturity (on the basis of purchase price) of the stripped obligation or coupon,

“(2) the amount of original issue discount determined under paragraph (1) shall be taken into account in determining the adjusted basis of the holder under section 1288,

“(3) subsection (b)(1) shall not apply, and

“(4) subsection (b)(2) shall be applied by increasing the basis of the bond or coupon by the interest accrued but not paid before the time such bond or coupon was disposed of (and not previously reflected in basis).”

1986—Subsec. (b)(1). Pub. L. 99-514, § 1803(a)(13)(B)(i), amended par. (1) generally, designating existing provisions as subpar. (A) and adding subpar. (B).

Subsec. (b)(2). Pub. L. 99-514, § 1803(a)(13)(B)(ii), substituted “the amount included in gross income under paragraph (1)” for “the amount of the accrued interest described in paragraph (1)”.

Subsec. (d). Pub. L. 99-514, § 1879(s)(1), amended subsec. (d) generally. Prior to amendment, subsec. (d) read as follows: “In the case of any tax-exempt obligation (as defined in section 1275(a)(3))—

“(1) subsections (a) and (b)(1) shall not apply,

“(2) the rules of subsection (b)(4) shall apply for purposes of subsection (c), and

“(3) subsection (c) shall be applied without regard to the requirement that the bond be purchased before July 2, 1982.”

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2018 AMENDMENT

Amendment by section 401(c)(2)(A)–(C) of Pub. L. 115-141 applicable to bonds purchased on or after July 2, 1982, see section 401(c)(2)(E) of Pub. L. 115-141, set out as a note under section 305 of this title.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to purchases and dispositions after Oct. 22, 2004, see section 831(c) of Pub. L. 108-357, set out as a note under section 305 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Pub. L. 100-647, title I, § 1018(q)(4)(B), Nov. 10, 1988, 102 Stat. 3586, provided that:

“(i) Except as provided in clause (ii), the amendment made by subparagraph (A) [amending this section] shall apply to any purchase or sale after June 10, 1987, of any stripped tax-exempt obligation or stripped coupon from such an obligation.

“(ii) If—

“(I) any person held any obligation or coupon in stripped form on June 10, 1987, and

“(II) such obligation or coupon was held by such person on such date for sale in the ordinary course of such person’s trade or business,

the amendment made by subparagraph (A) shall not apply to any sale of such obligation or coupon by such person and shall not apply to any such obligation or coupon while held by another person who purchased

such obligation or coupon from the person referred to in subclause (I).”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1803(a)(13)(B) of Pub. L. 99-514 applicable to obligations acquired after Oct. 22, 1986, see section 1803(a)(13)(C) of Pub. L. 99-514, set out as a note under section 1276 of this title.

Pub. L. 99-514, title XVIII, § 1879(s)(2), Oct. 22, 1986, 100 Stat. 2913, provided that: “The amendment made by paragraph (1) [amending this section] shall apply to any purchase or sale of any stripped tax-exempt obligation or stripped coupon from such an obligation after the date of the enactment of this Act [Oct. 22, 1986].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1287. Denial of capital gain treatment for gains on certain obligations not in registered form

(a) In general

If any registration-required obligation is not in registered form, any gain on the sale or other disposition of such obligation shall be treated as ordinary income (unless the issuance of such obligation was subject to tax under section 4701).

(b) Definitions

For purposes of subsection (a)—

(1) Registration-required obligation

The term “registration-required obligation” has the meaning given to such term by section 163(f)(2).

(2) Registered form

The term “registered form” has the same meaning as when used in section 163(f).

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 552; amended Pub. L. 111-147, title V, § 502(a)(2)(D), Mar. 18, 2010, 124 Stat. 107.)

Editorial Notes

AMENDMENTS

2010—Subsec. (b)(1). Pub. L. 111-147 struck out “except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shall not apply” before period.

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by Pub. L. 111-147 applicable to obligations issued after the date which is 2 years after Mar. 18, 2010, see section 502(f) of Pub. L. 111-147, set out as a note under section 149 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of

Pub. L. 98-369, set out as a note under section 1271 of this title.

§ 1288. Treatment of original issue discount on tax-exempt obligations

(a) General rule

Original issue discount on any tax-exempt obligation shall be treated as accruing—

(1) for purposes of section 163, in the manner provided by section 1272(a) (determined without regard to paragraph (7) thereof), and

(2) for purposes of determining the adjusted basis of the holder, in the manner provided by section 1272(a) (determined with regard to paragraph (7) thereof).

(b) Definitions and special rules

For purposes of this section—

(1) Original issue discount

The term “original issue discount” has the meaning given to such term by section 1273(a) without regard to paragraph (3) thereof. In applying section 483 or 1274, under regulations prescribed by the Secretary, appropriate adjustments shall be made to the applicable Federal rate to take into account the tax exemption for interest on the obligation.

(2) Tax-exempt obligation

The term “tax-exempt obligation” has the meaning given to such term by section 1275(a)(3).

(3) Short-term obligations

In applying this section to obligations with maturity of 1 year or less, rules similar to the rules of section 1283(b) shall apply.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 553; amended Pub. L. 100-647, title I, §1006(u)(3), Nov. 10, 1988, 102 Stat. 3427.)

Editorial Notes

AMENDMENTS

1988—Subsec. (a). Pub. L. 100-647 substituted “paragraph (7)” for “paragraph (6)” in pars. (1) and (2).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations issued after Sept. 3, 1982, and acquired after Mar. 1, 1984, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

Subpart

- A. Interest on tax deferral.
- B. Treatment of qualified electing funds.
- C. Election of mark to market for marketable stock.
- D. General provisions.

Editorial Notes

AMENDMENTS

1997—Pub. L. 105-34, title XI, §1122(d)(6), Aug. 5, 1997, 111 Stat. 977, added items for subparts C and D and struck out former item for subpart C “General provisions”.

SUBPART A—INTEREST ON TAX DEFERRAL

Sec.

1291. Interest on tax deferral.

§ 1291. Interest on tax deferral

(a) Treatment of distributions and stock dispositions

(1) Distributions

If a United States person receives an excess distribution in respect of stock in a passive foreign investment company, then—

(A) the amount of the excess distribution shall be allocated ratably to each day in the taxpayer’s holding period for the stock,

(B) with respect to such excess distribution, the taxpayer’s gross income for the current year shall include (as ordinary income) only the amounts allocated under subparagraph (A) to—

(i) the current year, or

(ii) any period in the taxpayer’s holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a passive foreign investment company, and

(C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under subsection (c)).

(2) Dispositions

If the taxpayer disposes of stock in a passive foreign investment company, then the rules of paragraph (1) shall apply to any gain recognized on such disposition in the same manner as if such gain were an excess distribution.

(3) Definitions

For purposes of this section—

(A) Holding period

The taxpayer’s holding period shall be determined under section 1223; except that—

(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

(ii) if section 1296 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 so applied.

(B) Current year

The term “current year” means the taxable year in which the excess distribution or disposition occurs.

(b) Excess distribution

(1) In general

For purposes of this section, the term “excess distribution” means any distribution in