

other position of the conversion transaction that is not disposed of, terminated, or treated as sold under any provision of the Code or regulations thereunder within 14 days of and within the same taxable year as the realization event.

(d) *Examples.* These examples illustrate this section:

Example 1. Identified netting transaction with simultaneous actual dispositions. (i) On December 1, 1995, A purchases 1,000 shares of XYZ stock for \$100,000 and enters into a forward contract to sell 1,000 shares of XYZ stock on November 30, 1997, for \$110,000. The XYZ stock is actively traded as defined in §1.1092(d)-1(a) and is a capital asset in A's hands. A maintains books and records on which, on December 1, 1995, it identifies the two positions as all the positions of a single conversion transaction. A owns no other XYZ stock. On December 1, 1996, when the applicable imputed income amount for the transaction is \$7,000, A sells the 1,000 shares of XYZ stock for \$95,000. On the same day, A terminates its forward contract with its counterparty, receiving \$10,200. No dividends were received on the stock during the time it was part of the conversion transaction.

(ii) The XYZ stock and forward contract are positions of a conversion transaction. Under section 1258(c)(1), substantially all of A's expected return from the overall transaction is attributable to the time value of the net investment in the transaction. Under section 1258(c)(2)(B), the transaction is an applicable straddle as defined in section 1258(d)(1).

(iii) A disposed of or terminated all the positions of the conversion transaction within 14 days and within the same taxable year as required by paragraph (b)(1) of this section. The transaction is an identified netting transaction because it meets the identification requirement of paragraph (b)(2) of this section. Solely for purposes of section 1258(a), the \$5,000 loss realized (\$100,000 basis less \$95,000 amount realized) on the disposition of the XYZ stock is netted against the \$10,200 gain recognized on the disposition of the forward contract. Thus, the net gain from the conversion transaction for purposes of section 1258(a) is \$5,200 (\$10,200 gain less \$5,000 loss). Only the \$5,200 net gain is recharacterized as ordinary income under section 1258(a) even though the applicable imputed income amount is \$7,000. For Federal tax purposes other than section 1258(a), A has recognized a \$10,200 gain on the disposition of the forward contract (\$5,200 of which is treated as ordinary income) and realized a separate \$5,000 loss on the sale of the XYZ stock.

Example 2. Identified netting transaction with built-in loss. (i) The facts are the same as in

Example 1, except that A had purchased the XYZ stock for \$104,000 on May 15, 1995. The XYZ stock had a fair market value of \$100,000 on December 1, 1995, the date it became part of a conversion transaction.

(ii) The results are the same as in *Example 1*, except that A has built-in loss (in addition to the \$5,000 loss that arose economically during the period of the conversion transaction), as defined in section 1258(d)(3)(B), of \$4,000 on the XYZ stock. That \$4,000 built-in loss is not netted against the \$10,200 gain on the forward contract for purposes of section 1258(a). Thus, the net gain from the conversion transaction for purposes of section 1258(a) is \$5,200, the same as in *Example 1*. The \$4,000 built-in loss is recognized and has a character determined without regard to section 1258.

(e) *Effective date and transition rule—*
(1) *In general.* These regulations are effective for conversion transactions that are outstanding on or after December 21, 1995.

(2) *Transition rule for identification requirements.* In the case of a conversion transaction entered into before February 20, 1996, paragraph (b)(2) of this section is treated as satisfied if the identification is made before the close of business on February 20, 1996.

[T.D. 8649, 60 FR 66084, Dec. 21, 1995]

§ 1.1271-0 Original issue discount; effective date; table of contents.

(a) *Effective date.* Except as otherwise provided, §§1.1271-1 through 1.1275-5 apply to debt instruments issued on or after April 4, 1994. Taxpayers, however, may rely on these sections (as contained in 26 CFR part 1 revised April 1, 1996) for debt instruments issued after December 21, 1992, and before April 4, 1994.

(b) *Table of contents.* This section lists captioned paragraphs contained in §§1.1271-1 through 1.1275-7T.

§ 1.1271-1 Special rules applicable to amounts received on retirement, sale, or exchange of debt instruments.

- (a) Intention to call before maturity.
 - (1) In general.
 - (2) Exceptions.
- (b) Short-term obligations.
 - (1) In general.
 - (2) Method of making elections.
 - (3) Counting conventions.

§ 1.1272-1 Current inclusion of OID in income.

- (a) Overview.
 - (1) In general.

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- (2) Debt instruments not subject to OID inclusion rules.
- (b) Accrual of OID.
 - (1) Constant yield method.
 - (2) Exceptions.
 - (3) Modifications.
 - (4) Special rules for determining the OID allocable to an accrual period.
- (c) Yield and maturity of certain debt instruments subject to contingencies.
 - (1) Applicability.
 - (2) Payment schedule that is significantly more likely than not to occur.
 - (3) Mandatory sinking fund provision.
 - (4) Consistency rule. [Reserved]
 - (5) Treatment of certain options.
 - (6) Subsequent adjustments.
 - (7) Effective date.
- (d) Certain debt instruments that provide for a fixed yield.
- (e) Convertible debt instruments.
- (f) Special rules to determine whether a debt instrument is a short-term obligation.
 - (1) Counting of either the issue date or maturity date.
 - (2) Coordination with paragraph (c) of this section for certain sections of the Internal Revenue Code.
- (g) Basis adjustment.
- (h) Debt instruments denominated in a currency other than the U.S. dollar.
 - (i) [Reserved]
 - (j) Examples.

§ 1.1272-2 *Treatment of debt instruments purchased at a premium.*

- (a) In general.
- (b) Definitions and special rules.
 - (1) Purchase.
 - (2) Premium.
 - (3) Acquisition premium.
 - (4) Acquisition premium fraction.
 - (5) Election to accrue discount on a constant yield basis.
 - (6) Special rules for determining basis.
- (c) Examples.

§ 1.1272-3 *Election by a holder to treat all interest on a debt instrument as OID.*

- (a) Election.
 - (b) Scope of election.
 - (1) In general.
 - (2) Exceptions, limitations, and special rules.
 - (c) Mechanics of the constant yield method.
 - (1) In general.
 - (2) Special rules to determine adjusted basis.
 - (d) Time and manner of making the election.
 - (e) Revocation of election.
 - (f) Effective date.

§ 1.1273-1 *Definition of OID.*

- (a) In general.

- (b) Stated redemption price at maturity.
- (c) Qualified stated interest.
 - (1) Definition.
 - (2) Debt instruments subject to contingencies.
 - (3) Variable rate debt instrument.
 - (4) Stated interest in excess of qualified stated interest.
 - (5) Short-term obligations.
- (d) De minimis OID.
 - (1) In general.
 - (2) De minimis amount.
 - (3) Installment obligations.
 - (4) Special rule for interest holidays, teaser rates, and other interest shortfalls.
 - (5) Treatment of de minimis OID by holders.
- (e) Definitions.
 - (1) Installment obligation.
 - (2) Self-amortizing installment obligation.
 - (3) Weighted average maturity.
- (f) Examples.

§ 1.1273-2 *Determination of issue price and issue date.*

- (a) Debt instruments issued for money.
 - (1) Issue price.
 - (2) Issue date.
- (b) Publicly traded debt instruments issued for property.
 - (1) Issue price.
 - (2) Issue date.
- (c) Debt instruments issued for publicly traded property.
 - (1) Issue price.
 - (2) Issue date.
- (d) Other debt instruments.
 - (1) Issue price.
 - (2) Issue date.
- (e) Special rule for certain sales to bond houses, brokers, or similar persons.
- (f) Traded on an established market (publicly traded).
 - (1) In general.
 - (2) Exchange listed property.
 - (3) Market traded property.
 - (4) Property appearing on a quotation medium.
 - (5) Readily quotable debt instruments.
 - (6) Effect of certain temporary restrictions on trading.
 - (7) Convertible debt instruments.
- (g) Treatment of certain cash payments incident to lending transactions.
 - (1) Applicability.
 - (2) Payments from borrower to lender.
 - (3) Payments from lender to borrower.
 - (4) Payments between lender and third party.
 - (5) Examples.
 - (h) Investment units.
 - (1) In general.
 - (2) Consistent allocation by holders and issuer.
 - (i) [Reserved]
 - (j) Convertible debt instruments.

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(k) Below-market loans subject to section 7872(b).

- (1) [Reserved]
- (m) Treatment of amounts representing pre-issuance accrued interest.
 - (1) Applicability.
 - (2) Exclusion of pre-issuance accrued interest from issue price.
 - (3) Example.

§ 1.1274-1 Debt instruments to which section 1274 applies.

- (a) In general.
- (b) Exceptions.
 - (1) Debt instrument with adequate stated interest and no OID .
 - (2) Exceptions under sections 1274(c)(1)(B), 1274(c)(3), 1274A(c), and 1275(b)(1).
 - (3) Other exceptions to section 1274.
- (c) Examples.

§ 1.1274-2 Issue price of debt instruments to which section 1274 applies.

- (a) In general.
- (b) Issue price.
 - (1) Debt instruments that provide for adequate stated interest; stated principal amount.
 - (2) Debt instruments that do not provide for adequate stated interest; imputed principal amount.
 - (3) Debt instruments issued in a potentially abusive situation; fair market value.
- (c) Determination of whether a debt instrument provides for adequate stated interest.
 - (1) In general.
 - (2) Determination of present value.
 - (d) Treatment of certain options.
 - (e) Mandatory sinking funds.
 - (f) Treatment of variable rate debt instruments.
 - (1) Stated interest at a qualified floating rate.
 - (2) Stated interest at a single objective rate.
 - (g) Treatment of contingent payment debt instruments.
 - (h) Examples.
 - (i) [Reserved]
 - (j) Special rules for tax-exempt obligations.
 - (1) Certain variable rate debt instruments.
 - (2) Contingent payment debt instruments.
 - (3) Effective date.

§ 1.1274-3 Potentially abusive situations defined.

- (a) In general.
- (b) Operating rules.
 - (1) Debt instrument exchanged for non-recourse financing.
 - (2) Nonrecourse debt with substantial down payment.
 - (3) Clearly excessive interest.
- (c) Other situations to be specified by Commissioner.
- (d) Consistency rule.

§ 1.1274-4 Test rate.

- (a) Determination of test rate of interest.
 - (1) In general.
 - (2) Test rate for certain debt instruments.
 - (b) Applicable Federal rate.
 - (c) Special rules to determine the term of a debt instrument for purposes of determining the applicable Federal rate.
 - (1) Installment obligations.
 - (2) Certain variable rate debt instruments.
 - (3) Counting of either the issue date or the maturity date.
 - (4) Certain debt instruments that provide for principal payments uncertain as to time.
 - (d) Foreign currency loans.
 - (e) Examples.

§ 1.1274-5 Assumptions.

- (a) In general.
- (b) Modifications of debt instruments.
 - (1) In general.
 - (2) Election to treat buyer as modifying the debt instrument.
 - (c) Wraparound indebtedness.
 - (d) Consideration attributable to assumed debt.

§ 1.1274A-1 Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.

- (a) In general.
- (b) Rules for both qualified and cash method debt instruments.
 - (1) Sale-leaseback transactions.
 - (2) Debt instruments calling for contingent payments.
 - (3) Aggregation of transactions.
 - (4) Inflation adjustment of dollar amounts.
 - (c) Rules for cash method debt instruments.
 - (1) Time and manner of making cash method election.
 - (2) Successors of electing parties.
 - (3) Modified debt instrument.
 - (4) Debt incurred or continued to purchase or carry a cash method debt instrument.

§ 1.1275-1 Definitions.

- (a) Applicability.
- (b) Adjusted issue price.
 - (1) In general.
 - (2) Adjusted issue price for subsequent holders.
 - (c) OID.
 - (d) Debt instrument.
 - (e) Tax-exempt obligations.
 - (f) Issue.
 - (1) *Debt instruments issued on or after March 13, 2001.*
 - (2) *Debt instruments issued before March 13, 2001.*
 - (3) *Transition rule.*
 - (4) *Cross-references for reopening and aggregation rules.*
 - (g) Debt instruments issued by a natural person.

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- (h) Publicly offered debt instrument.
- (i) [Reserved]
- (j) Life annuity exception under section 1275(a)(1)(B)(i).
 - (1) Purpose.
 - (2) General rule.
 - (3) Availability of a cash surrender option.
 - (4) Availability of a loan secured by the contract.
 - (5) Minimum payout provision.
 - (6) Maximum payout provision.
 - (7) Decreasing payout provision.
 - (8) Effective dates.

§ 1.1275-2 Special rules relating to debt instruments.

- (a) Payment ordering rule.
 - (1) In general.
 - (2) Exceptions.
- (b) Debt instruments distributed by corporations with respect to stock.
 - (1) Treatment of distribution.
 - (2) Issue date.
 - (c) Aggregation of debt instruments.
 - (1) General rule.
 - (2) Exception if separate issue price established.
 - (3) Special rule for debt instruments that provide for the issuance of additional debt instruments.
 - (4) Examples.
 - (d) *Special rules for Treasury securities.*
 - (1) *Issue price and issue date.*
 - (2) *Reopenings of Treasury securities.*
 - (e) Disclosure of certain information to holders.
 - (f) Treatment of pro rata prepayments.
 - (1) Treatment as retirement of separate debt instrument.
 - (2) Definition of pro rata prepayment.
 - (g) Anti-abuse rule.
 - (1) In general.
 - (2) Unreasonable result.
 - (3) Examples.
 - (4) Effective date.
 - (h) Remote and incidental contingencies.
 - (1) In general.
 - (2) Remote contingencies.
 - (3) Incidental contingencies.
 - (4) Aggregation rule.
 - (5) Consistency rule.
 - (6) Subsequent adjustments.
 - (7) Effective date.
 - (i) [Reserved]
 - (j) Treatment of certain modifications.
 - (k) *Reopenings.*
 - (1) *In general.*
 - (2) *Definitions.*
 - (3) *Qualified reopening.*
 - (4) *Issuer's treatment of a qualified reopening.*
 - (5) *Effective date.*

§ 1.1275-3 OID information reporting requirements.

- (a) In general.

- (b) Information required to be set forth on face of debt instruments that are not publicly offered.
 - (1) In general.
 - (2) Time for legending.
 - (3) Legend must survive reissuance upon transfer.
 - (4) Exceptions.
 - (c) Information required to be reported to Secretary upon issuance of publicly offered debt instruments.
 - (1) In general.
 - (2) Time for filing information return.
 - (3) Exceptions.
 - (d) Application to foreign issuers and U.S. issuers of foreigntargeted debt instruments.
 - (e) Penalties.
 - (f) Effective date.

§ 1.1275-4 Contingent payment debt instruments.

- (a) Applicability.
 - (1) In general.
 - (2) Exceptions.
 - (3) Insolvency and default.
 - (4) Convertible debt instruments.
 - (5) Remote and incidental contingencies.
- (b) Noncontingent bond method.
 - (1) Applicability.
 - (2) In general.
 - (3) Description of method.
 - (4) Comparable yield and projected payment schedule.
 - (5) Qualified stated interest.
 - (6) Adjustments.
 - (7) Adjusted issue price, adjusted basis, and retirement.
 - (8) Character on sale, exchange, or retirement.
 - (9) Operating rules.
- (c) Method for debt instruments not subject to the noncontingent bond method.
 - (1) Applicability.
 - (2) Separation into components.
 - (3) Treatment of noncontingent payments.
 - (4) Treatment of contingent payments.
 - (5) Basis different from adjusted issue price.
 - (6) Treatment of a holder on sale, exchange, or retirement.
 - (7) Examples.
 - (d) Rules for tax-exempt obligations.
 - (1) In general.
 - (2) Certain tax-exempt obligations with interest-based or revenue-based payments
 - (3) All other tax-exempt obligations.
 - (4) Basis different from adjusted issue price.
 - (e) Amounts treated as interest under this section.
 - (f) Effective date.

§ 1.1275-5 Variable rate debt instruments.

- (a) Applicability.
 - (1) In general.
 - (2) Principal payments.
 - (3) Stated interest.

- (4) Current value.
- (5) No contingent principal payments.
- (6) Special rule for debt instruments issued for nonpublicly traded property.
 - (b) Qualified floating rate.
 - (1) In general.
 - (2) Certain rates based on a qualified floating rate.
 - (3) Restrictions on the stated rate of interest.
 - (c) Objective rate.
 - (1) Definition.
 - (2) Other objective rates to be specified by Commissioner.
 - (3) Qualified inverse floating rate.
 - (4) Significant front-loading or back-loading of interest.
 - (5) Tax-exempt obligations.
 - (d) Examples.
 - (e) Qualified stated interest and OID with respect to a variable rate debt instrument.
 - (1) In general.
 - (2) Variable rate debt instrument that provides for annual payments of interest at a single variable rate.
 - (3) All other variable rate debt instruments except for those that provide for a fixed rate.
 - (4) Variable rate debt instrument that provides for a single fixed rate.
 - (f) Special rule for certain reset bonds.

§ 1.1275-6 Integration of qualifying debt instruments.

- (a) In general.
- (b) Definitions.
 - (1) Qualifying debt instrument.
 - (2) Section 1.1275-6 hedge.
 - (3) Financial instrument.
 - (4) Synthetic debt instrument.
- (c) Integrated transaction.
 - (1) Integration by taxpayer.
 - (2) Integration by Commissioner.
 - (d) Special rules for legging into and legging out of an integrated transaction.
 - (1) Legging into.
 - (2) Legging out.
 - (e) Identification requirements.
 - (f) Taxation of integrated transactions.
 - (1) General rule.
 - (2) Issue date.
 - (3) Term.
 - (4) Issue price.
 - (5) Adjusted issue price.
 - (6) Qualified stated interest.
 - (7) Stated redemption price at maturity.
 - (8) Source of interest income and allocation of expense.
 - (9) Effectively connected income.
 - (10) Not a short-term obligation.
 - (11) Special rules in the event of integration by the Commissioner.
 - (12) Retention of separate transaction rules for certain purposes.
 - (13) Coordination with consolidated return rules.
 - (g) Predecessors and successors.
 - (h) Examples.

- (i) [Reserved]
- (j) Effective date.

§ 1.1275-7 Inflation-indexed debt instruments.

- (a) Overview.
- (b) Applicability.
 - (1) In general.
 - (2) Exceptions.
- (c) Definitions.
 - (1) Inflation-indexed debt instrument.
 - (2) Reference index.
 - (3) Qualified inflation index.
 - (4) Inflation-adjusted principal amount.
 - (5) Minimum guarantee payment.
- (d) Coupon bond method.
 - (1) In general.
 - (2) Applicability.
 - (3) Qualified stated interest.
 - (4) Inflation adjustments.
 - (5) Example.
- (e) Discount bond method.
 - (1) In general.
 - (2) No qualified stated interest.
 - (3) OID.
 - (4) Example.
- (f) Special rules.
 - (1) Deflation adjustments.
 - (2) Adjusted basis.
 - (3) Subsequent holders.
 - (4) Minimum guarantee.
 - (5) Temporary unavailability of a qualified inflation index.
- (g) *Reopenings*.
- (h) Effective date.

[T.D. 8517, 59 FR 4808, Feb. 2, 1994, as amended by T.D. 8674, 61 FR 30139, June 14, 1996; T.D. 8709, 62 FR 617, Jan. 6, 1997; T.D. 8754, 63 FR 1057, Jan. 8, 1998; T.D. 8838, 64 FR 48547, Sept. 7, 1999; T.D. 8840, 64 FR 60343, Nov. 5, 1999; T.D. 8934, 66 FR 2815, Jan. 12, 2001]

§ 1.1271-1 Special rules applicable to amounts received on retirement, sale, or exchange of debt instruments.

(a) *Intention to call before maturity*—(1) *In general.* For purposes of section 1271(a)(2), all or a portion of gain realized on a sale or exchange of a debt instrument to which section 1271 applies is treated as interest income if there was an intention to call the debt instrument before maturity. An intention to call a debt instrument before maturity means a written or oral agreement or understanding not provided for in the debt instrument between the issuer and the original holder of the debt instrument that the issuer will redeem the debt instrument before maturity. In the case of debt instruments that are part of an issue, the agreement or understanding must be