

treated as bond premium, \$2,000, representing the excess of the consideration received for the bond-option investment units over the maturity value of the bonds, and has accordingly prorated and included in income \$1,200 of such amount. Starting with the first taxable year beginning on or after Dec. 24, 1968, N Corporation may amortize as a deduction over the remaining life of the bonds the amount of \$2,200 (\$1,000 discount, plus \$1,200 previously included in income).

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

(c) *Deduction upon repurchase.* (1) Except as provided in subparagraphs (2) and (3) of this paragraph, if bonds are issued by a corporation and are subsequently repurchased by the corporation at a price in excess of the issue price plus any amount of discount deducted prior to repurchase, or (in the case of bonds issued subsequent to Feb. 28, 1913) minus any amount of premium returned as income prior to repurchase, the excess of the purchase price over the issue price adjusted for amortized premium or discount is a deductible expense for the taxable year.

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

gate that an amount in excess of 1 year's interest does not include any amount attributable to the conversion feature.

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

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

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

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

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

(a) *In general.* (1) If an obligation is issued by a corporation with original issue discount, the amount of such discount is deductible as interest and shall be prorated or amortized over the life of the obligation. For purposes of this section the term "obligation" shall have the same meaning as in § 1.1232-1 (without regard to whether the obligation is a capital asset in the hands of the holder) and the term "original issue discount" shall have the same meaning as in section 1232(b)(1) (without regard to the one-fourth of 1 percent limitation in the second sentence thereof). Thus, in general, the amount of original issue discount equals the excess of the amount payable at maturity over the issue price of the bond (as defined in paragraph (b)(2) of § 1.1232-3), regardless of whether that amount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity.

For the rule as to whether there is original issue discount in the case of an obligation issued in an exchange for property other than money, and the amount thereof, see paragraph (b)(2)(iii) of § 1.1232-3. In any case in which original issue discount is carried over from one corporation to another corporation under section 381(c)(9) or from an obligation exchanged to an obligation received in any exchange under paragraph (b)(1)(iv) of § 1.1232-3, such discount shall be carried over for purposes of this section. The amount of original issue discount carried over in an exchange of obligations under the preceding sentence shall be prorated or amortized over the life of the obligation issued in such exchange. For computation of issue price and the amount of original issue discount in the case of serial obligations, see paragraph (b)(2)(iv) of § 1.1232-3.

(2) In the case of an obligation issued by a corporation as part of an investment unit (as defined in paragraph (b)(2)(ii)(a) of § 1.1232-3) consisting of an obligation and other property, the issue price of the obligation is determined by allocating the amount received for the investment unit to the individual elements of the unit in the manner set forth in paragraph (b)(2)(ii) of § 1.1232-3.

(3) *Recovery or retention of amounts previously deducted.* In any taxable year in which an amount of original issue discount which was deducted as interest under this section is retained or recovered by the taxpayer, such as, for example, by reason of a fine, penalty, forfeiture, or other withdrawal fee, such amount shall be includible in the gross income of such taxpayer for such taxable year.

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

Example (1). N Corporation, which uses the calendar year as its taxable year, on January 1, 1970, issued for \$99,000, 9 percent bonds maturing 10 years from the date of issue, with a stated redemption price at maturity of \$100,000. The original issue discount on each bond (as determined under section 1232(b)(1) without regard to the one-fourth-of-1-percent limitation in the second sentence thereof) is \$1,000, i.e., redemption price, \$100,000, minus issue price, \$99,000. N shall treat \$1,000 as the

total amount to be amortized over the life of the bonds.

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

Example (3). Assume the same facts as example (1), except that the bonds are issued as part of an investment unit consisting of an obligation and an option. Assume further that the issue price of the bonds as determined under the rules of allocation set forth in paragraph (b)(2)(ii) of § 1.1232-3 is \$94,000. The original issue discount on the bond (as determined under section 1232(b)(1) without regard to the one-fourth-of-1-percent limitation in the second sentence thereof) is \$6,000, i.e., redemption price, \$100,000, minus issue price, \$94,000. N shall treat \$6,000 as the total amount to be amortized over the life of the bonds.

Example (4). On January 1, 1971, a commercial bank which uses the calendar year as its taxable year, issued a certificate of deposit for \$10,000. The certificate of deposit is not redeemable until December 31, 1975, except in an emergency as defined in, and subject to the qualifications provided by Regulations Q of the Board of Governors of the Federal Reserve. See 12 CFR § 217.4(d). The stated redemption price at maturity is \$13,382.26. The certificate is an obligation to which section 1232(a)(3)(A) applies (see paragraph (d) of § 1.1232-1), and the original issue discount with respect to the certificate (as determined under section 1232(b)(1) without regard to the one-fourth-of-1-percent limitation in the second sentence thereof) is \$3,382.26 (i.e., redemption price, \$13,382.26, minus issued price, \$10,000). Y shall treat \$3,382.26 as the total amount to be amortized over the life of the certificate.

(c) *Deduction upon repurchase.* (1) Except as provided in subparagraph (2) of this paragraph, if bonds are issued by a corporation and are subsequently repurchased by the corporation at a price in excess of the issue price plus any amount of original issue discount deducted prior to repurchase, or minus any amount of premium returned as income prior to repurchase, the excess of the repurchase price over the issue price adjusted for amortized premium or deducted discount is deductible as interest for the taxable year.

(2) The provisions of subparagraph (1) of this paragraph shall not apply to the extent a deduction is disallowed by section 249 (relating to limitation on deduction of bond premium or repurchase

of convertible obligation) and the regulations thereunder.

(d) *Effective date.* The provisions of this section shall apply in respect of obligations issued after May 27, 1969, other than—

(1) Obligations issued pursuant to a written commitment which was binding on May 27, 1969, and at all times thereafter, and

(2) Deposits made before January 1, 1971, in the case of certificates of deposit, time deposits, bonus plans, and other deposit arrangements with banks, domestic building and loan associations, and similar financial institutions.

[36 FR 24996, Dec. 28, 1971, as amended by T.D. 7213, 37 FR 21991, Oct. 18, 1972; T.D. 7259, 38 FR 4253, Feb. 12, 1973]

§ 1.163-5 Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form.

(a)-(b) [Reserved]

(c) *Obligations issued to foreign persons after September 21, 1984—(1) In general.* A determination of whether an obligation satisfies each of the requirements of this paragraph shall be made on an obligation-by-obligation basis. An obligation issued directly (or through affiliated entities) in bearer form by, or guaranteed by, a United States Government-owned agency or a United States Government-sponsored enterprise, such as the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Loan Mortgage Corporation, the Farm Credit Administration, and the Student Loan Marketing Association, may not satisfy this paragraph (c). An obligation issued after September 21, 1984 is described in this paragraph if—

(i) There are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with its original issuance) only to a person who is not a United States person or who is a United States person that is a financial institution (as defined in § 1.165-12(c)(1)(v)) purchasing for its own account or for the account of a customer and that agrees to comply with the requirements of section 165(j)(3) (A), (B), or (C) and the regulations thereunder, and

(ii) In the case of an obligation which is not in registered form—

(A) Interest on such obligation is payable only outside the United States and its possessions, and

(B) Unless the obligation is described in subparagraph (2)(i)(C) of this paragraph or is a temporary global security, the following statement in English either appears on the face of the obligation and on any interest coupons which may be detached therefrom or, if the obligation is evidenced by a book entry, appears in the book or record in which the book entry is made: “Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code.” For purposes of this paragraph, the term “temporary global security” means a security which is held for the benefit of the purchasers of the obligations of the issuer and interests in which are exchangeable for securities in definitive registered or bearer form prior to its stated maturity.

(2) *Rules for the application of this paragraph—(i) Arrangements reasonably designed to ensure sale to non-United States persons.* An obligation will be considered to satisfy paragraph (c)(1)(i) of this section if the conditions of paragraph (c)(2)(i) (A), (B), (C), or (D) of this section are met in connection with the original issuance of the obligation. An exchange of one obligation for another is considered an original issuance if and only if the exchange constitutes a disposition of property for purposes of section 1001 of the Code. However, an exchange of one obligation for another will not be considered a new issuance if the obligation received is identical in all respects to the obligation surrendered in exchange therefor, except that the obligor of the obligation received need not be the same obligor as the obligor of the obligation surrendered. Obligations that meet the conditions of paragraph (c)(2)(i) (A), (B), (C) or (D) of this section may be issued in a single public offering. The preceding sentence does not apply to certificates of deposit issued under the conditions of paragraph (c)(2)(i)(C) of this section by a United States person or by a controlled