

and quarterly interest payments of \$2,500 thereafter (beginning on July 1, 1995). The issue price of the debt instrument is \$97,561. C chooses to accrue OID based on quarterly accrual periods.

(i) *De minimis amount of OID.* But for the interest holiday, all stated interest on the debt instrument would be qualified stated interest. Under paragraph (d)(4) of this section, for purposes of determining whether the debt instrument has de minimis OID, the stated redemption price at maturity of the instrument is \$100,061 (\$97,561 (issue price) plus \$2,500 (the greater of the amount of foregone interest (\$2,500) and the amount equal to the excess of the instrument's stated principal amount over its issue price (\$2,439)). Thus, the debt instrument is treated as having OID of \$2,500 (\$100,061 minus \$97,561). Because this amount is less than the de minimis amount of \$3,001.83 (0.0025 multiplied by \$100,061 multiplied by 12 complete years to maturity), the debt instrument is treated as having no OID, and all stated interest is treated as qualified stated interest.

Example 6. De minimis OID; teaser rate. (i) *Facts.* The facts are the same as in *Example 5* of this paragraph (f) except that C uses an initial semiannual accrual period rather than an initial quarterly accrual period.

(ii) *De minimis amount of OID.* The debt instrument provides for an initial teaser rate because the interest rate for the semiannual accrual period is less than the interest rate applicable to the subsequent quarterly accrual periods. But for the initial teaser rate, all stated interest on the debt instrument would be qualified stated interest. Under paragraph (d)(4) of this section, for purposes of determining whether the debt instrument has de minimis OID, the stated redemption price at maturity of the instrument is \$100,123.50 (\$97,561 (issue price) plus \$2,562.50 (the greater of the amount of foregone interest (\$2,562.50) and the amount equal to the excess of the instrument's stated principal amount over its issue price (\$2,439)). Thus, the debt instrument is treated as having OID of \$2,562.50 (\$100,123.50 minus \$97,561). Because this amount is less than the de minimis amount of \$3,003.71 (0.0025 multiplied by \$100,123.50 multiplied by 12 complete years to maturity), the debt instrument is treated as having no OID, and all stated interest is treated as qualified stated interest.

[T.D. 8517, 59 FR 4815, Feb. 2, 1994, as amended by T.D. 8674, 61 FR 30141, June 14, 1996]

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

(a) *Debt instruments issued for money—*

(1) *Issue price.* If a substantial amount of the debt instruments in an issue is issued for money, the issue price of each debt instrument in the issue is

the first price at which a substantial amount of the debt instruments is sold for money. Thus, if an issue consists of a single debt instrument that is issued for money, the issue price of the debt instrument is the amount paid for the instrument. For example, in the case of a debt instrument evidencing a loan to a natural person, the issue price of the instrument is the amount loaned. See § 1.1275-2(d) for rules regarding Treasury securities. For purposes of this paragraph (a), money includes functional currency and, in certain circumstances, nonfunctional currency. See § 1.988-2(b)(2) for circumstances when nonfunctional currency is treated as money rather than as property.

(2) *Issue date.* The issue date of an issue described in paragraph (a)(1) of this section is the first settlement date or closing date, whichever is applicable, on which a substantial amount of the debt instruments in the issue is sold for money.

(b) *Publicly traded debt instruments issued for property—*(1) *Issue price.* If a substantial amount of the debt instruments in an issue is traded on an established market (within the meaning of paragraph (f) of this section) and the issue is not described in paragraph (a)(1) of this section, the issue price of each debt instrument in the issue is the fair market value of the debt instrument, determined as of the issue date (as defined in paragraph (b)(2) of this section).

(2) *Issue date.* The issue date of an issue described in paragraph (b)(1) of this section is the first date on which a substantial amount of the traded debt instruments in the issue is issued.

(c) *Debt instruments issued for publicly traded property—*(1) *Issue price.* If a substantial amount of the debt instruments in an issue is issued for property that is traded on an established market (within the meaning of paragraph (f) of this section) and the issue is not described in paragraph (a)(1) or (b)(1) of this section, the issue price of each debt instrument in the issue is the fair market value of the property, determined as of the issue date (as defined in paragraph (c)(2) of this section). For purposes of the preceding sentence, property means a debt instrument, stock, security, contract, commodity,

or nonfunctional currency. But see § 1.988-2(b)(2) for circumstances when nonfunctional currency is treated as money rather than as property.

(2) *Issue date.* The issue date of an issue described in paragraph (c)(1) of this section is the first date on which a substantial amount of the debt instruments in the issue is issued for traded property.

(d) *Other debt instruments*—(1) *Issue price.* If an issue of debt instruments is not described in paragraph (a)(1), (b)(1), or (c)(1) of this section, the issue price of each debt instrument in the issue is determined as if the debt instrument were a separate issue. If the issue price of a debt instrument that is treated as a separate issue under the preceding sentence is not determined under paragraph (a)(1), (b)(1), or (c)(1) of this section, and if section 1274 applies to the debt instrument, the issue price of the instrument is determined under section 1274. Otherwise, the issue price of the debt instrument is its stated redemption price at maturity under section 1273(b)(4). See section 1274(c) and § 1.1274-1 to determine if section 1274 applies to a debt instrument.

(2) *Issue date.* The issue date of an issue described in paragraph (d)(1) of this section is the date on which the debt instrument is issued for money or in a sale or exchange.

(e) *Special rule for certain sales to bond houses, brokers, or similar persons.* For purposes of determining the issue price and issue date of a debt instrument under this section, sales to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers are ignored.

(f) *Traded on an established market (publicly traded)*—(1) *In general.* Property (including a debt instrument described in paragraph (b)(1) of this section) is traded on an established market for purposes of this section if, at any time during the 60-day period ending 30 days after the issue date, the property is described in paragraph (f)(2), (f)(3), (f)(4), or (f)(5) of this section.

(2) *Exchange listed property.* Property is described in this paragraph (f)(2) if it is listed on—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3); or

(iii) The International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited, the Frankfurt Stock Exchange, the Tokyo Stock Exchange, or any other foreign exchange or board of trade that is designated by the Commissioner in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter).

(3) *Market traded property.* Property is described in this paragraph (f)(3) if it is property of a kind that is traded either on a board of trade designated as a contract market by the Commodities Futures Trading Commission or on an interbank market.

(4) *Property appearing on a quotation medium.* Property is described in this paragraph (f)(4) if it appears on a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices (including rates, yields, or other pricing information) of recent sales transactions (a quotation medium). A quotation medium does not include a directory or listing of brokers, dealers, or traders for specific securities, such as yellow sheets, that provides neither price quotations nor actual prices of recent sales transactions.

(5) *Readily quotable debt instruments*—

(i) *In general.* A debt instrument is described in this paragraph (f)(5) if price quotations are readily available from dealers, brokers, or traders.

(ii) *Safe harbors.* A debt instrument is not considered to be described in paragraph (f)(5)(i) of this section if—

(A) No other outstanding debt instrument of the issuer (or of any person who guarantees the debt instrument) is described in paragraph (f)(2), (f)(3), or

(f)(4) of this section (other traded debt);

(B) The original stated principal amount of the issue that includes the debt instrument does not exceed \$25 million;

(C) The conditions and covenants relating to the issuer's performance with respect to the debt instrument are materially less restrictive than the conditions and covenants included in all of the issuer's other traded debt (e.g., the debt instrument is subject to an economically significant subordination provision whereas the issuer's other traded debt is senior); or

(D) The maturity date of the debt instrument is more than 3 years after the latest maturity date of the issuer's other traded debt.

(6) *Effect of certain temporary restrictions on trading.* If there is any temporary restriction on trading a purpose of which is to avoid the characterization of the property as one that is traded on an established market for Federal income tax purposes, then the property is treated as traded on an established market. For purposes of the preceding sentence, a temporary restriction on trading need not be imposed by the issuer.

(7) *Convertible debt instruments.* A debt instrument is not treated as traded on an established market solely because the debt instrument is convertible into property that is so traded.

(g) *Treatment of certain cash payments incident to lending transactions—(1) Applicability.* The provisions of this paragraph (g) apply to cash payments made incident to private lending transactions (including seller financing).

(2) *Payments from borrower to lender—(i) Money lending transaction.* In a lending transaction to which section 1273(b)(2) applies, a payment from the borrower to the lender (other than a payment for property or for services provided by the lender, such as commitment fees or loan processing costs) reduces the issue price of the debt instrument evidencing the loan. However, solely for purposes of determining the tax consequences to the borrower, the issue price is not reduced if the payment is deductible under section 461(g)(2).

(ii) *Section 1274 transaction.* In a lending transaction to which section 1274 applies, a payment from the buyer-borrower to the seller-lender that is designated as interest or points reduces the stated principal amount of the debt instrument evidencing the loan, but is included in the purchase price of the property. If the payment is deductible under section 461(g)(2), however, the issue price of the debt instrument (as otherwise determined under section 1274 and the rule in the preceding sentence) is increased by the amount of the payment to compute the buyer-borrower's interest deductions under section 163.

(3) *Payments from lender to borrower.* A payment from the lender to the borrower in a lending transaction is treated as an amount loaned.

(4) *Payments between lender and third party.* If, as part of a lending transaction, a party other than the borrower (the third party) makes a payment to the lender, that payment is treated in appropriate circumstances as made from the third party to the borrower followed by a payment in the same amount from the borrower to the lender and governed by the provisions of paragraph (g)(2) of this section. If, as part of a lending transaction, the lender makes a payment to a third party, that payment is treated in appropriate circumstances as an additional amount loaned to the borrower and then paid by the borrower to the third party. The character of the deemed payment between the borrower and the third party depends on the substance of the transaction.

(5) *Examples.* The following examples illustrate the rules of this paragraph (g).

Example 1. Payments from borrower to lender in a cash transaction. (i) *Facts.* A lends \$100,000 to B for a term of 10 years. At the time the loan is made, B pays \$4,000 in points to A. Assume that the points are not deductible by B under section 461(g)(2) and that the stated redemption price at maturity of the debt instrument is \$100,000.

(ii) *Payment results in OID.* Under paragraph (g)(2)(i) of this section, the issue price of B's debt instrument evidencing the loan is \$96,000. Because the amount of OID on the debt instrument (\$4,000) is more than a de minimis amount of OID, A accounts for the

OID under § 1.1272-1. B accounts for the OID under § 1.163-7.

Example 2. Payments from borrower to lender in a section 1274 transaction. (i) *Facts.* A sells property to B for \$1,000,000 in a transaction that is not a potentially abusive situation (within the meaning of § 1.1274-3). In consideration for the property, B gives A \$300,000 and issues a 5-year debt instrument that has a stated principal amount of \$700,000, payable at maturity, and that calls for semiannual payments of interest at a rate of 8.5 percent. In addition to the cash downpayment, B pays A \$14,000 designated as points on the loan. Assume that the points are not deductible under section 461(g)(2).

(ii) *Issue price.* Under paragraph (g)(2)(ii) of this section, the stated principal amount of B's debt instrument is \$686,000 (\$700,000 minus \$14,000). Assuming a test rate of 9 percent, compounded semiannually, the imputed principal amount of B's debt instrument under § 1.1274-2(c)(1) is \$686,153. Under § 1.1274-2(b)(1), the issue price of B's debt instrument is the stated principal amount of \$686,000. Because the amount of OID on the debt instrument (\$700,000 - \$686,000, or \$14,000) is more than a de minimis amount of OID, A accounts for the OID under § 1.1272-1 and B accounts for the OID under § 1.163-7. B's basis in the property purchased is \$1,000,000 (\$686,000 debt instrument plus \$314,000 cash payments).

Example 3. Payments between lender and third party (seller-paid points). (i) *Facts.* A sells real property to B for \$500,000 in a transaction that is not a potentially abusive situation (within the meaning of § 1.1274-3). B makes a cash down payment of \$100,000 and borrows \$400,000 of the purchase price from a lender, L, repayable in annual installments over a term of 15 years calling for interest at a rate of 9 percent, compounded annually. As part of the transaction, A makes a payment of \$8,000 to L to facilitate the loan to B.

(ii) *Payment results in a de minimis amount of OID.* Under the provisions of paragraphs (g)(2)(i) and (g)(4) of this section, B is treated as having made an \$8,000 payment directly to L and a payment of only \$492,000 to A for the property. Thus, B's basis in the property is \$492,000. The payment to L reduces the issue price of B's debt instrument to \$392,000, resulting in \$8,000 of OID (\$400,000 - \$392,000). Because the amount of OID is de minimis under § 1.1273-1(d), L accounts for the de minimis OID under § 1.1273-1(d)(5). But see § 1.1272-3 (election to treat de minimis OID as OID). B accounts for the de minimis OID under § 1.163-7.

(h) *Investment units—(1) In general.* Under section 1273(c)(2), an investment unit is treated as if the investment unit were a debt instrument. The issue price of the investment unit is determined under paragraph (a)(1), (b)(1), or

(c)(1) of this section, if applicable. The issue price of the investment unit is then allocated between the debt instrument and the property right (or rights) that comprise the unit based on their relative fair market values. If paragraphs (a)(1), (b)(1), and (c)(1) of this section are not applicable, however, the issue price of the debt instrument that is part of the investment unit is determined under section 1273(b)(4) or 1274, whichever is applicable.

(2) *Consistent allocation by holders and issuer.* The issuer's allocation of the issue price of the investment unit is binding on all holders of the investment unit. However, the issuer's determination is not binding on a holder that explicitly discloses that its allocation is different from the issuer's allocation. Unless otherwise provided by the Commissioner, the disclosure must be made on a statement attached to the holder's timely filed Federal income tax return for the taxable year that includes the acquisition date of the investment unit. See § 1.1275-2(e) for rules relating to the issuer's obligation to disclose certain information to holders.

(i) [Reserved]

(j) *Convertible debt instruments.* The issue price of a debt instrument includes any amount paid for an option to convert the instrument into stock (or another debt instrument) of either the issuer or a related party (within the meaning of section 267(b) or 707(b)(1)) or into cash or other property in an amount equal to the approximate value of such stock (or debt instrument).

(k) *Below-market loans subject to section 7872(b).* The issue price of a below-market loan subject to section 7872(b) (a term loan other than a gift loan) is the issue price determined under this section, reduced by the excess amount determined under section 7872(b)(1).

(l) [Reserved]

(m) *Treatment of amounts representing pre-issuance accrued interest—(1) Applicability.* Paragraph (m)(2) of this section provides an alternative to the general rule of this section for determining the issue price of a debt instrument if—

(i) A portion of the initial purchase price of the instrument is allocable to

interest that has accrued prior to the issue date (pre-issuance accrued interest); and

(ii) The instrument provides for a payment of stated interest on the first payment date within 1 year of the issue date that equals or exceeds the amount of the pre-issuance accrued interest.

(2) *Exclusion of pre-issuance accrued interest from issue price.* If a debt instrument meets the requirements of paragraph (m)(1) of this section, the instrument's issue price may be computed by subtracting from the issue price (as otherwise computed under this section) the amount of pre-issuance accrued interest. If the issue price of the debt instrument is computed in this manner, a portion of the stated interest payable on the first payment date must be treated as a return of the excluded pre-issuance accrued interest, rather than as an amount payable on the instrument.

(3) *Example.* The following example illustrates the rule of paragraph (m) of this section.

Example: (i) *Facts.* On January 15, 1995, A purchases at original issue, for \$1,005, B corporation's debt instrument. The debt instrument provides for a payment of principal of \$1,000 on January 1, 2005, and provides for semiannual interest payments of \$60 on January 1 and July 1 of each year, beginning on July 1, 1995.

(ii) *Determination of pre-issuance accrued interest.* Under paragraphs (m)(1) and (m)(2) of this section, \$5 of the \$1,005 initial purchase price of the debt instrument is allocable to pre-issuance accrued interest. Accordingly, the debt instrument's issue price may be computed by subtracting the amount of pre-issuance accrued interest (\$5) from the issue price otherwise computed under this section (\$1,005), resulting in an issue price of \$1,000. If the issue price is computed in this manner, \$5 of the \$60 payment made on July 1, 1995, must be treated as a repayment by B of the pre-issuance accrued interest.

[T.D. 8517, 59 FR 4817, Feb. 2, 1994]

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

(a) *In general.* Subject to the exceptions and limitations in paragraph (b) of this section, section 1274 and this section apply to any debt instrument issued in consideration for the sale or exchange of property. For purposes of section 1274, property includes debt instruments and investment units, but

does not include money, services, or the right to use property. For the treatment of certain obligations given in exchange for services or the use of property, see sections 404 and 467. For purposes of this paragraph (a), money includes functional currency and, in certain circumstances, nonfunctional currency. See § 1.988-2(b)(2) for circumstances when nonfunctional currency is treated as money rather than as property.

(b) *Exceptions—(1) Debt instrument with adequate stated interest and no OID.* Section 1274 does not apply to a debt instrument if—

(i) All interest payable on the instrument is qualified stated interest;

(ii) The stated rate of interest is at least equal to the test rate of interest (as defined in § 1.1274-4);

(iii) The debt instrument is not issued in a potentially abusive situation (as defined in § 1.1274-3); and

(iv) No payment from the buyer-borrower to the seller-lender designated as points or interest is made at the time of issuance of the debt instrument.

(2) *Exceptions under sections 1274(c)(1)(B), 1274(c)(3), 1274A(c), and 1275(b)(1)—(i) In general.* Sections 1274(c)(1)(B), 1274(c)(3), 1274A(c), and 1275(b)(1) describe certain transactions to which section 1274 does not apply. This paragraph (b)(2) provides certain rules to be used in applying those exceptions.

(ii) *Special rules for certain exceptions under section 1274(c)(3)—(A) Determination of sales price for certain sales of farms.* For purposes of section 1274(c)(3)(A), the determination as to whether the sales price cannot exceed \$1,000,000 is made without regard to any other exception to, or limitation on, the applicability of section 1274 (e.g., without regard to the special rules regarding sales of principal residences and land transfers between related persons). In addition, the sales price is determined without regard to section 1274 and without regard to any stated interest. The sales price includes the amount of any liability included in the amount realized from the sale or exchange. See § 1.1001-2.

(B) *Sales involving total payments of \$250,000 or less.* Under section 1274(c)(3)(C), the determination of the