§ 1.475(c)-1 Definitions—dealer in securities

(a) Dealer-customer relationship. Whether a taxpayer is transacting business with customers is determined on the basis of all of the facts and circumstances.

(1) [Reserved]

(2) Transactions described in section 475(c)(1)(B)—(i) In general. For purposes of section 475(c)(1)(B), the term dealer in securities includes, but is not limited to, a taxpayer that, in the ordinary course of the taxpayer’s trade or business, regularly holds itself out as being willing and able to enter into either side of transactions enumerated in section 475(c)(1)(B).

(ii) Examples. The following examples illustrate the rules of this paragraph (a)(2). In the following examples, B is a bank and is not a member of a consolidated group:

Example 1. B regularly offers to enter into interest rate swaps with other persons in the ordinary course of its trade or business. B is willing to enter into interest rate swaps under which it either pays a fixed interest rate and receives a floating rate or pays a floating rate and receives a fixed rate. B is a dealer in securities under section 475(c)(1)(B), and the counterparties are its customers.

Example 2. B, in the ordinary course of its trade or business, regularly holds itself out as being willing and able to enter into either side of positions in a foreign currency with other banks in the interbank market. B’s activities in the foreign currency make it a dealer in securities under section 475(c)(1)(B), and the other banks in the interbank market are its customers.

Example 3. B engages in frequent transactions in a foreign currency in the interbank market. Unlike the facts in Example 2, however, B does not regularly hold itself out as being willing and able to enter into either side of positions in the foreign currency, and all of B’s transactions are driven by its internal need to adjust its position in the currency. No other circumstances are present to suggest that B is a dealer in securities for purposes of section 475(c)(1)(B). B’s activity in the foreign currency does not qualify it as a dealer in securities for purposes of section 475(c)(1)(B), and its transactions in the interbank market are not transactions with customers.

(iii) Related parties—(1) General rule. Except as provided in paragraph (a)(3)(ii) of this section (concerning transactions between members of a consolidated group, as defined in §1.1502-1(h)), a taxpayer’s transactions with related persons may be transactions with customers for purposes of section 475. For example, if a taxpayer, in the ordinary course of the taxpayer’s trade or business, regularly holds itself out to its foreign subsidiaries or other related persons as being willing and able to enter into either side of transactions enumerated in section 475(c)(1)(B), the taxpayer is a dealer in securities within the meaning of section 475(c)(1), even if it engages in no other transactions with customers.

(1) Special rule for members of a consolidated group. Solely for purposes of
paragraph (c)(1) of section 475 (concerning the definition of dealer in securities) and except as provided in paragraph (a)(3)(iii) of this section, a taxpayer’s transactions with other members of its consolidated group are not with customers. Accordingly, notwithstanding paragraph (a)(2) of this section, the fact that a taxpayer regularly holds itself out to other members of its consolidated group as being willing and able to enter into either side of a transaction enumerated in section 475(c)(1)(B) does not cause the taxpayer to be a dealer in securities within the meaning of section 475(c)(1)(B).

(iii) The intragroup-customer election—
(A) Effect of election. If a consolidated group makes the intragroup-customer election, paragraph (a)(3)(i) of this section (special rule for members of a consolidated group) does not apply to the members of the group. Thus, a member of a group that has made this election may be a dealer in securities within the meaning of section 475(c)(1) even if its only customer transactions are with other members of its consolidated group.

(B) Making and revoking the election. Unless the Commissioner otherwise prescribes, the intragroup-customer election is made by filing a statement that says, “[Insert name and employer identification number of common parent] hereby makes the Intragroup-Customer Election (as described in §1.475(c)-1(a)(3)(iii) of the income tax regulations) for the taxable year ending [describe the last day of the year] and for subsequent taxable years.’ The statement must be signed by the common parent and attached to the timely filed federal income tax return for the consolidated group for that taxable year. The election applies for that year and continues in effect for subsequent years until revoked. The election may be revoked only with the consent of the Commissioner.

(iv) Examples. The following examples illustrate this paragraph (a)(3):

Example 1. General facts. HC, a hedging center, provides interest rate hedges to all of the members of its affiliated group (as defined in section 1561(a)(1)). Because of the efficiencies created by having a centralized risk manager, group policy prohibits members other than HC from entering into derivative interest rate positions with outside parties. HC regularly holds itself out as being willing and able to, and in fact does, enter into either side of a transaction enumerated in section 475(c)(1)(B). Because of the efficiencies with which the affiliate’s affiliated group operates the intragroup-customer election, the fact that HC regularly holds itself out to other members of the affiliate’s affiliated group as being willing and able to enter into either side of a transaction enumerated in section 475(c)(1)(B) does not cause the taxpayer to be a dealer in securities within the meaning of section 475(c)(1)(B).

Example 2. Special rule for members of a consolidated group. In addition to the General Facts stated above, assume that HC’s affiliated group has not elected to file consolidated returns and has not made the intragroup-customer election. Under paragraph (a)(3)(i) of this section, HC’s transactions with its affiliates can be transactions with customers for purposes of section 475(c)(1). Thus, under paragraph (a)(2)(i) of this section, HC is a dealer in securities within the meaning of section 475(c)(1)(B), and the members of the group with which it does business are its customers.

Example 3. Intragroup-customer election. In addition to the General Facts stated above, assume that HC’s affiliated group has elected to file consolidated returns but has also made the intragroup-customer election under paragraph (a)(3)(iii) of this section. Thus, the analysis and result are the same as in Example 1.
(b) Sellers of nonfinancial goods and services—(1) Purchases and sales of customer paper. Except as provided in paragraph (b)(3) of this section, if a taxpayer would not be a dealer in securities within the meaning of section 475(c)(1) but for its purchases and sales of debt instruments that, at the time of purchase or sale, are customer paper with respect to either the taxpayer or a corporation that is a member of the same consolidated group (as defined in §1.1502–1(h)) as the taxpayer, then for purposes of section 475 the taxpayer is not a dealer in securities.

(2) Definition of customer paper. A debt instrument is customer paper with respect to a person at a point in time if—

(i) The person’s principal activity is selling nonfinancial goods or providing nonfinancial services;

(ii) The debt instrument was issued by a purchaser of the goods or services at the time of the purchase of those goods or services in order to finance the purchase; and

(iii) At all times since the debt instrument was issued, it has been held either by the person selling those goods or services or by a corporation that is a member of the same consolidated group as that person.

(3) Exceptions. Paragraph (b)(1) of this section does not apply if—

(i) For purposes of section 471, the taxpayer accounts for any security (as defined in section 475(c)(2)) as inventory;

(ii) The taxpayer is subject to an election under paragraph (b)(4) of this section; or

(iii) The taxpayer is not described in the preceding sentence, the statement must be attached to the first federal income tax return that is for a taxable year subject to the election and that is filed on or after February 24, 1997.

(4) Election not to be governed by the exception for sellers of nonfinancial goods or services—(i) Method of making the election. Unless the Commissioner otherwise prescribes, an election under this paragraph (b)(4) must be made in the manner, and at the time, prescribed in this paragraph (b)(4)(i). The taxpayer must file with the Internal Revenue Service a statement that says, “[name] hereby elects not to be governed by §1.475(c)(1)(b)(1) of the income tax regulations for the taxable year ending [describe the last day of the year] and for subsequent taxable years.”

(A) Taxable years ending after December 24, 1996. If the first taxable year subject to an election under this paragraph (b)(4) ends after December 24, 1996, the statement must be attached to a timely filed federal income tax return for that taxable year.

(B) Taxable years ending on or before December 24, 1996. If the first taxable year subject to an election under this paragraph (b)(4) ends on or before December 24, 1996 and the election changes the taxpayer’s taxable income for any taxable year the federal income tax return for which was filed before February 24, 1997, the statement must be attached to an amended return for the earliest such year that is so affected, and that amended return (and an amended return for any other such year that is so affected) must be filed not later than June 23, 1997. If the first taxable year subject to an election under this paragraph (b)(4) ends on or before December 24, 1996 but the taxpayer is not described in the preceding sentence, the statement must be attached to the first federal income tax return that is for a taxable year subject to the election and that is filed on or after February 24, 1997.

(ii) Continued applicability of an election. An election under this paragraph (b)(4) continues in effect for subsequent taxable years until revoked. The election may be revoked only with the consent of the Commissioner.

(c) Taxpayers that purchase securities from customers but engage in no more than negligible sales of the securities—(1) Exemption from dealer status—(i) General rule. A taxpayer that regularly purchases securities from customers in the ordinary course of a trade or business (including regularly making loans to customers in the ordinary course of a trade or business of making loans) but
engages in no more than negligible sales of the securities so acquired is not a dealer in securities within the meaning of section 475(c)(1) unless the taxpayer elects to be so treated or, for purposes of section 471, the taxpayer accounts for any security (as defined in section 475(c)(2)) as inventory.  

(ii) Election to be treated as a dealer. A taxpayer described in paragraph (c)(1)(i) of this section elects to be treated as a dealer in securities by filing a federal income tax return reflecting the application of section 475(a) in computing its taxable income.  

(2) Negligible sales. Solely for purposes of paragraph (c)(1) of this section, a taxpayer engages in negligible sales of debt instruments that it regularly purchases from customers in the ordinary course of its business if, and only if, during the taxable year, either—  

(i) The taxpayer sells all or part of fewer than 60 debt instruments, regardless how acquired; or  

(ii) The total adjusted basis of the debt instruments (or parts of debt instruments), regardless how acquired, that the taxpayer sells is less than 5 percent of the total basis, immediately after acquisition, of the debt instruments that it acquires in that year.  

(3) Special rules for members of a consolidated group—(i) Intragroup-customer election in effect. If a taxpayer is a member of a consolidated group that has made the intragroup-customer election (described in paragraph (a)(3)(iii) of this section), the negligible sales test in paragraph (c)(2) of this section takes into account all of the taxpayer’s sales of debt instruments to other group members.  

(ii) Intragroup-customer election not in effect. If a taxpayer is a member of a consolidated group that has not made the intragroup-customer election (described in paragraph (a)(3)(iii) of this section), the taxpayer satisfies the negligible sales test in paragraph (c)(2) of this section if either—  

(A) The test is satisfied by the taxpayer, taking into account sales of debt instruments to other group members (as in paragraph (c)(3)(i) of this section); or  

(B) The test is satisfied by the group, treating the members of the group as if they were divisions of a single corporation.  

(4) Special rules. Whether sales of securities are negligible is determined without regard to—  

(i) Sales of securities that are necessitated by exceptional circumstances and that are not undertaken as recurring business activities;  

(ii) Sales of debt instruments that decline in quality while in the taxpayer’s hands and that are sold pursuant to an established policy of the taxpayer to dispose of debt instruments below a certain quality; or  

(iii) Acquisitions and sales of debt instruments that are qualitatively different from all debt instruments that the taxpayer purchases from customers in the ordinary course of its business.  

(5) Example. The following example illustrates paragraph (c)(4)(iii) of this section:  

Example. I, an insurance company, regularly makes policy loans to its customers but does not sell them. I, however, actively trades Treasury securities. No other circumstances are present to suggest that I is a dealer in securities for purposes of section 475(c)(1). Since the Treasuries are qualitatively different from the policy loans that I originates, under paragraph (c)(4)(iii) of this section, I disregards the purchases and sales of Treasuries in applying the negligible sales test in paragraph (c)(2) of this section.  

(d) Issuance of life insurance products. A life insurance company that is not otherwise a dealer in securities within the meaning of section 475(c)(1) does not become a dealer in securities solely because it regularly issues life insurance products to its customers in the ordinary course of a trade or business. For purposes of the preceding sentence, the term life insurance product means a contract that is treated for federal income tax purposes as an annuity, endowment, or life insurance contract. See sections 72, 817, and 7702.  