be unavailable to the transferor without securing consent from the Commissioner). In determining the principal purpose of a transfer, consideration will be given to all of the facts and circumstances. However, a transfer is deemed made with the principal purpose to avail the transferee of a method of accounting that would be unavailable to the transferor without securing consent from the Commissioner if the transferor acquired inventory in a bargain purchase within the five taxable years preceding the year of the transfer and used a dollar-value LIFO method to account for that inventory that did not treat the bargain purchase inventory and physically identical inventory acquired at market prices as separate items. Inventory is deemed acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was less than or equal to 50 percent of the replacement cost of physically identical inventory. Inventory is not considered acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was greater than or equal to 75 percent of the replacement cost of physically identical inventory.

(4) Effective date. The rules of this paragraph (h) are applicable for transfers that occur during a taxable year ending on or after December 31, 2001.


§ 1.475–0 Table of contents.

This section lists the major captions in §§1.475(a)–3, 1.475(a)–4, 1.475(b)–1, 1.475(b)–2, 1.475(b)–4, 1.475(c)–1, 1.475(c)–2, 1.475(d)–1 and 1.475(g)–1.

§§1.475(a)–1—1.475(a)–2 [Reserved]

§ 1.475(a)–3 Acquisition by a dealer of a security with a substituted basis.

(a) Scope.

(b) Rules.

§ 1.475(a)–4 Safe Harbor for Valuation Under Section 475.

(a) Overview.

(1) Purpose.

(2) Dealer business model.

(3) Summary of paragraphs.

(b) Safe harbor.

(1) General rule.

(2) Example. Use of eligible and non-eligible methods.

(3) Scope of the safe harbor.

(c) Eligible taxpayer.

(d) Eligible method.

(1) Sufficient consistency.

(2) General requirements.

(i) Frequency.

(ii) Recognition at the mark.

(iii) Recognition on disposition.

(iv) Fair value standard.

(3) Limitations.

(1) Bid-ask method.

(A) General Rule.

(B) Safe harbor.

(ii) By the taxpayer.

(iii) By the Commissioner.

(iv) Re-election.

(5) Eligible positions.

(h) Applicable financial statement.

(1) Definition.

(2) Primary financial statement.

(i) Statement required to be filed with Securities and Exchange Commission (SEC).

(ii) Statement filed with a Federal agency other than the IRS.

(iii) Certified audited financial statement.

(3) Example. Primary financial statement.

(4) Financial statements of equal priority.

(5) Consolidated groups.

(6) Supplement or amendment to a financial statement.

(7) Certified audited financial statement.

(i) [Reserved]

(j) Significance business use.

(1) In general.

(2) Financial statement value.

(3) Management of a business as a dealer.

(4) Significant use.

(k) Retention and production of records.

(1) In general.

(2) Specific requirements.

(i) Reconciliation.

(A) In general.

(B) Values on books and records with supporting schedules.

(C) Consolidation schedules.

(ii) Instructions provided by the Commissioner.

(i) Time for producing records.

(4) Retention period for records.

(5) Agreements with the Commissioner.

(i) [Reserved]

(m) Use of different values.

568
§ 1.475(b)–1 Scope of exemptions from mark-to-market requirement.

(a) Securities held for investment or not held for sale.
   (b) Securities deemed identified as held for investment.
      (1) In general.
      (2) Relationships.
      (i) General rule.
      (ii) Attributed.
      (iii) Trusts treated as partnerships.
      (3) Securities traded on certain established financial markets.
         (i) Changes in status.
         (ii) Termination of prohibition against marking.
         (iii) Examples.
      (4) Securities deemed not held for investment; dealers in notional principal contracts and derivatives.
      (d) Special rule for hedges of another member's risk.
      (e) Transitional rules.
            (i) In general.
            (ii) Control defined.
            (iii) Applicability.
            (i) General rule.
            (ii) Exception for securities not acquired in dealer capacity.
            (iii) Applicability.

§ 1.475(b)–2 Exemptions—identification requirements.

(a) Identification of the basis for exemption.
   (b) Time for identifying a security with a substituted basis.
   (c) Integrated transactions under § 1.1275–6.
      (1) Definitions.
      (2) Synthetic debt held by a taxpayer as a result of legging in.
      (3) Securities held after legging out.

§ 1.475(b)–3 [Reserved]

§ 1.475(b)–4 Exemptions—transitional issues.

(a) Transitional identification.
   (1) Certain securities previously identified under section 1296.
   (2) Consistency requirement for other securities.
   (b) Corrections on or before January 31, 1994.
      (1) Purpose.
      (2) To conform to § 1.475(b)–1(a).
      (i) Added identifications.
      (ii) Limitations.
      (3) To conform to § 1.475(b)–1(c).

§ 1.475(c)–1 Definitions—dealer in securities.

(a) Dealer-customer relationship.
   (1) [Reserved]
   (2) Transactions described in section 475(c)(1)(B).
      (i) In general.
      (ii) Examples.
      (iii) Related parties.
      (iv) General rule.
      (v) Special rule for members of a consolidated group.
         (i) The intragroup-customer election.
         (A) Effect of election.
         (B) Making and revoking the election.
         (iv) Examples.
         (b) Sellers of nonfinancial goods and services.
            (1) Purchases and sales of customer paper.
            (2) Definition of customer paper.
            (3) Exceptions.
            (4) Election not to be governed by the exception for sellers of nonfinancial goods or services.
            (i) Method of making the election.
               (A) Taxable years ending after December 24, 1996.
               (B) Taxable years ending on or before December 24, 1996.
            (ii) Continued applicability of an election.
            (c) Taxpayers that purchase securities from customers but engage in no more than negligible sales of the securities.
               (1) Exemption from dealer status.
               (ii) Election to be treated as a dealer.
               (2) Negligible sales.
               (3) Special rules for members of a consolidated group.
                  (i) Intragroup-customer election in effect.
                  (ii) Intragroup-customer election not in effect.
                  (4) Special rules.
                  (5) Example.
               (d) Issuance of life insurance products.

§ 1.475(c)–2 Definitions—security.

(a) Items that are not securities.
   (b) Synthetic debt that § 1.1275–6(b) treats the taxpayer as holding.
   (c) Negative value REMIC residuals acquired before January 4, 1995.
   (1) Description.
   (2) Special rules applicable to negative value REMIC residuals acquired before January 4, 1995.

§ 1.475(d)–1 Character of gain or loss.

(a) Securities never held in connection with the taxpayer’s activities as a dealer in securities.
   (b) Ordinary treatment for notional principal contracts and derivatives held by dealers in notional principal contracts and derivatives.
§ 1.475(a)–1 Effective dates.


§ 1.475(a)–2 [Reserved]

§ 1.475(a)–3 Acquisition by a dealer of a security with a substituted basis.

(a) Scope. This section applies if—

(1) A dealer in securities acquires a security that is subject to section 475(a) and the dealer’s basis in the security is determined, in whole or in part, by reference to the basis of that security in the hands of the person from whom the security was acquired; or

(2) A dealer in securities acquires a security that is subject to section 475(a) and the dealer’s basis in the security is determined, in whole or in part, by reference to other property held at any time by the dealer.

(b) Rules. If this section applies to a security—

(1) Section 475(a) applies only to changes in value of the security occurring after the acquisition; and

(2) Any built-in gain or loss with respect to the security (based on the difference between the fair market value of the security on the date the dealer acquired it and its basis to the dealer on that date) is taken into account at the time, and has the character provided by the sections of the Internal Revenue Code that would apply to the built-in gain or loss if section 475(a) did not apply to the security.


§ 1.475(a)–4 Valuation safe harbor.

(a) Overview—(1) Purpose. This section sets forth a safe harbor that, under certain circumstances, permits taxpayers to elect to use the values of positions reported on certain financial statements as the fair market values of those positions for purposes of section 475. This safe harbor is based on the principle that, if a mark-to-market method used for financial reporting is sufficiently consistent with the requirements of section 475 and if the financial statement employing that method has certain indicia of reliability, then the values used on that financial statement may be used for purposes of section 475. If other provisions of the Internal Revenue Code or regulations require adjustments to fair market value, use of the safe harbor does not eliminate the need for those adjustments. See paragraph (e) of this section.

(2) Dealer business model. The safe harbor is based on the business model for a derivatives dealer. Under this model, the dealer seeks to capture and profit from bid-ask spreads in the marketplace by entering into substantially offsetting positions with customers that will remain on the derivatives dealer’s books over their terms. Because the positions in the aggregate tend to offset each other, the dealer has achieved a predictable net cash flow (for example, a synthetic annuity) that reflects the captured bid-ask spread. This net cash flow is generally impervious to market fluctuations in the values on which the component derivatives are based. Section 475 requires current recognition of the present value of the net cash flow attributable to the capture of these spreads.

(3) Summary of paragraphs. Paragraph (b) of this section sets forth the safe harbor. To determine who may use the safe harbor, paragraph (c) of this section defines the term “eligible taxpayer.” Paragraph (d) of this section sets forth the basic requirements for determining whether the method used for financial reporting is sufficiently consistent with the requirements of section 475. Paragraph (e) of this section describes adjustments to the financial statement values that may be required for purposes of applying this safe harbor. Paragraph (f) of this section describes the procedure for making the safe harbor election and the conditions under which the election may be revoked. Paragraph (g) of this section provides that the Commissioner will issue a revenue procedure that lists the types of securities and commodities that are eligible positions for purposes of the safe harbor. Using rules for determining priorities among financial statements, paragraph (h) of this section defines the term “applicable financial statement” and so describes the financial statement, if any.