for 2012 is the lesser of: $23.35 ($31 of OID that accrues on the new debt instrument in 2012 less $7.75 of this OID that is allowed as a deduction to A in 2012) or $9.75 (the excess of $75 (ABC partnership's deferred COD income of $150 less A's share of ABC partnership's deferred COD income that is included in A's income for 2012 of $75) over $65.25 (the aggregate amount of OID that accrued in previous taxable years of $87 less the aggregate amount of such OID that has been allowed as a deduction by A in 2012 of $21.75)). Thus, of the $31 of OID that accrues in 2012, $9.75 is deferred under section 108(i).

(3) *Effect of an election under section 108(i) on recapture amounts under section 465(e)*—(i) *In general.* To the extent that a decrease in a partner's or shareholder's amount at risk (as defined in section 465) in an activity as a result of a reacquisition of an applicable debt instrument would cause a partner with a deferred amount or a shareholder with a share of the S corporation's deferred COD income to have income under section 465(e) in the taxable year of the reacquisition, such decrease (not to exceed the partner's deferred amount or the shareholder's share of the S corporation's deferred COD income with respect to that applicable debt instrument) (deferred section 465 amount) shall not be taken into account for purposes of determining the partner's or shareholder's amount at risk in an activity under section 465 as of the close of the taxable year of the reacquisition. A partner's or shareholder's deferred section 465 amount is treated as a decrease in the partner's or shareholder's amount at risk in an activity at the same time, and to the extent remaining in same amount, as the partner recognizes its deferred amount or the S corporation shareholder recognizes its share of the S corporation's deferred COD income.

(ii) *Example.* The following example illustrates the rules in paragraph (d)(3) of this section:

Example. (i) PRS is a calendar-year partnership with two equal partners, individuals A and B. PRS is engaged in an activity described in section 465(c) (Activity). PRS has a $500 recourse applicable debt instrument outstanding. Each partner's amount at risk on January 1, 2009 is $50. On June 1, 2009, the creditor agrees to cancel the $500 indebtedness. PRS realizes $500 of COD income as a result of the reacquisition. The partners' share of the liabilities of PRS decreases by $500 under section 752(b), and each partner's amount at risk is decreased by $250. Other than the $500 of COD income, PRS's income and expenses for 2009 are equal. PRS makes an election under section 108(i) to defer $200 of the $500 COD income realized in connection with the reacquisition. PRS allocates the $500 of COD income equally between its partners, A and B. A and B each have a COD income amount of $250 with respect to the applicable debt instrument. PRS determines that, for both partners A and B, $100 of the $250 COD income amount is the deferred amount, and $150 is the included amount. Beginning in each taxable year 2014 through 2018, A and B each include $20 of the deferred amount in gross income.

(ii) Under paragraph (d)(3)(i) of this section, $50 of the $250 decrease in A's and B's amount at risk in Activity is the deferred section 465 amount for each of A and B and is not taken into account for purposes of determining A's and B's amount at risk in Activity at the close of 2009. In taxable year 2014, A's and B's amount at risk in Activity is decreased by $20 (deferred section 465 amount that equals the deferred amount included in A's and B's gross income in 2014). In taxable year 2015, A's and B's amount at risk in Activity is decreased by $20 for the deferred section 465 amount that equals the deferred amount included in A's and B's gross income in 2015. In taxable year 2016, A's and B's amount at risk in Activity is decreased by $10 (the remaining amount of the deferred section 465 amount).

(e) *Election procedures and reporting requirements*—(1) *Partnerships*—(i) *In general.* A partnership makes an election under section 108(i) by following procedures outlined in guidance and applicable forms and instructions issued by the Commissioner. An electing partnership (or its successor) must provide to its partners certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(ii) *Tiered pass-through entities.* A partnership that is a direct or indirect partner of an electing partnership (or its successor) or a related partnership or an S corporation partner must provide to its partners or shareholders, as the case may be, certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(iii) *Related partnerships.* A related partnership must provide to its partners certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(2) *S corporations*—(i) *In general.* An S corporation makes an election under section 108(i) by following procedures outlined in guidance and applicable forms and instructions issued by the Commissioner. An electing S corporation (or its successor) must provide to its shareholders certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(ii) *Related S corporations.* A related S corporation must provide to its shareholders certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(f) *Effective/applicability date.* For the applicability dates of this section, *see* § 1.108(i)–0T(b).

(g) *Expiration date.* This section expires on August 9, 2013.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 3.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 4.** In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * *	*
1.108(i)–2T	1545–2147
* * * *	*

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: August 6, 2010.

Michael F. Mundaca,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2010–20058 Filed 8–11–10; 11:15 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9497]

RIN 1545–BI97

Guidance Regarding Deferred Discharge of Indebtedness Income of Corporations and Deferred Original Issue Discount Deductions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 108(i) of the Internal Revenue Code (Code). These regulations primarily affect C corporations regarding the acceleration of deferred discharge of indebtedness (COD) income (deferred COD income) and deferred original

issue discount (OID) deductions (deferred OID deductions) under section 108(i)(5)(D), and the calculation of earnings and profits as a result of an election under section 108(i). In addition, these regulations provide rules applicable to all taxpayers regarding deferred OID deductions under section 108(i) as a result of a reacquisition of an applicable debt instrument by an issuer or related party. The text of these temporary regulations also serves as the text of proposed regulations (REG–142800–09) set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective Dates:* These regulations are effective on August 11, 2010.

Applicability Dates: For dates of applicability, *see* § 1.108(i)–0T(b).

FOR FURTHER INFORMATION CONTACT: Concerning the acceleration rules for deferred COD income and deferred OID deductions, and the rules for earnings and profits, Robert M. Rhyne (202) 622–7790; concerning the rules for deferred OID deductions, Rubin B. Ranat (202) 622–7530 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–2147. Responses to this collection of information are required in order for a member of a consolidated group to make the election described in § 1.108(i)–1T(b)(3).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. *See* 26 U.S.C. 6001. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 61(a)(12), a taxpayer includes in gross income any discharge of indebtedness (COD income) if the taxpayer's obligation to repay its indebtedness is discharged in whole or in part. Section 108 provides special rules for the treatment of COD income in certain cases.

Section 108(i) was added to the Code by section 1231 of the American Recovery and Reinvestment Tax Act of 2009 (Pub. L. 111–5, 123 Stat. 338), enacted on February 17, 2009. Section 108(i)(1) provides an election for deferral of the inclusion of COD income (deferred COD income) arising in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument. If a taxpayer makes the election, the deferred COD income generally is includible in gross income ratably over a 5-taxable-year period, beginning with the taxpayer's fourth or fifth taxable year following the taxable year of the reacquisition (inclusion period). If, as part of a reacquisition to which section 108(i)(1) applies, a debt instrument is issued (or is treated as issued) for the applicable debt instrument and there is any OID with respect to the newly issued debt instrument, then the deduction for all or a portion of the OID may be deferred (deferred OID deductions) under section 108(i)(2). (*See* the discussion of section 108(i)(2) later in this preamble.)

An applicable debt instrument means any debt instrument (within the meaning of section 1275(a)(1)) issued by a C corporation, or any other person in connection with the conduct of a trade or business by such a person. Section 108(i)(3). Section 108(i)(4)(A) defines a *reacquisition* as any acquisition of the debt instrument by the debtor which issued (or is otherwise the obligor under) the debt instrument, or by a person related to the debtor within the meaning of section 108(e)(4). An *acquisition* includes acquisitions for cash or other property, for another debt instrument, for corporate stock or a partnership interest, or as a contribution of the debt instrument to capital. The term also includes the complete forgiveness of the indebtedness by the holder of the debt instrument. Section 108(i)(4)(B).

Section 108(i)(5)(D) requires a taxpayer to accelerate the inclusion of any remaining items of deferred COD income or deferred (and otherwise allowable) OID deduction (deferred items) under certain circumstances, including the death of the taxpayer, the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), the cessation of business by the taxpayer, or similar circumstances. Section 108(i)(7) authorizes the Secretary to issue guidance necessary or appropriate for purposes of applying section 108(i), including extending the application of the rules of section 108(i)(5)(D) to other appropriate circumstances.

On August 17, 2009, the IRS and Treasury Department issued Rev. Proc. 2009–37, 2009–36 IRB 309, providing procedures for taxpayers to make a section 108(i) election, and requiring the annual reporting of additional information. *See* § 601.601(d)(2)(ii)(*b*). The revenue procedure also announced the intention to issue additional guidance, and that the additional guidance may be retroactive.

Explanation of Provisions

I. Mandatory Acceleration Events for Deferred COD Income

The IRS and Treasury Department believe that the deferral rules of section 108(i) generally are intended to facilitate debt workouts and to alleviate taxpayer liquidity concerns by deferring the tax liability associated with COD income. These taxpayer-favorable deferral rules are tempered, however, by section 108(i)(5)(D), which operates to accelerate the inclusion of a taxpayer's remaining deferred COD income in the case of the death of the taxpayer, the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), the cessation of business by the taxpayer or similar circumstances (acceleration events).

A common trait of these enumerated acceleration events is that they involve situations where collection of the tax liability associated with a taxpayer's deferred COD income may be hindered, either because the taxpayer has ceased to exist or because the taxpayer has disposed of the business to which the COD income relates. Section 108(i) poses unique concerns regarding collectability of the incipient tax liability associated with deferred COD income. In other contexts in which gain or income is deferred, the deferral is generally associated with a particular asset or its replacement. For example, gain on the sale of an asset under the installment method of accounting is deferred until payments are received under the installment obligation, or until the taxpayer disposes of the installment obligation. Collectability of the tax liability associated with the deferred gain is preserved in that context because the taxpayer has either the installment obligation or the proceeds therefrom. Section 108(i) deferral, in contrast, is not linked to a particular asset or a particular replacement asset. In the absence of acceleration events, the government's ability to ensure appropriate inclusion of the deferred COD income and the collectability of the associated tax liability would be jeopardized.

The enumerated acceleration events apply, however, to a broad range of taxpayers, including individuals and passthrough entities as well as corporations. Applied literally, the statutory rules would require acceleration in circumstances, such as certain corporate nonrecognition transactions, that do not pose particular concerns regarding collectability. For example, the statute treats a sale of substantially all the assets of the taxpayer as an acceleration event. If construed broadly, any asset disposition involving the transfer of substantially all of the assets of a corporation that made a section 108(i) election (for example, a reorganization exchange described in section 368(a)(1)(C)) would constitute an acceleration event. However, commentators noted that it did not seem consistent with the purposes of section 108(i) to require the acceleration of an electing corporation's deferred items in the case of a transaction to which section 381(a) applies. As discussed further in this preamble, the IRS and Treasury Department generally agree.

The rules provided in these temporary regulations with respect to a C corporation with deferred COD income by reason of a section 108(i) election (electing corporation) are intended to focus more precisely on the underlying purpose of section 108(i)(5)(D) to ensure that the government's ability to collect the tax liability associated with the deferred COD income is not impaired. Thus, with respect to electing corporations, the rules provided in these regulations generally reflect a narrower interpretation of the statutory acceleration events.

In addition, however, the nature of the corporate entity introduces concerns not present for other types of taxpayers. In particular, a corporation can dissipate its assets (for example, by distributions to its shareholders) without harming the economic interests of its shareholders. As a result, there may be a greater incentive for the owners of a corporation to make the corporation judgment-proof with respect to its tax liability. This is illustrated by the intermediary transactions described in Notice 2008–111, 2008–2 CB 1299. The IRS and Treasury Department believe that the acceleration rules should be tailored to foreclose such opportunities.

Accordingly, while these temporary regulations do not require acceleration in every instance enumerated in the statute, they provide instead for acceleration in a limited number of circumstances in which corporations have impaired their ability to pay their incipient tax liability. This approach is broadly consistent with the approach advanced by commentators who suggested, for example, that a transfer of a corporation's business assets for stock in a section 351 exchange should not be an acceleration event, despite the literal language of section 108(i)(5)(D).

Specifically, these temporary regulations generally provide that an electing corporation will accelerate deferred COD income under section 108(i)(5)(D) if the electing corporation (i) changes its tax status, (ii) ceases its corporate existence in a transaction to which section 381(a) does not apply, or (iii) engages in a transaction that impairs its ability to pay the tax liability associated with its deferred COD income (the net value acceleration rule). Under these temporary regulations, the foregoing three rules are the only events that accelerate an electing corporation's deferred COD income. In addition to these temporary regulations, however, the rules under § 1.108(i)–2T apply to C corporations that are direct or indirect partners of a partnership.

The acceleration rules provided in these temporary regulations generally are different from the rules for passthrough entities. For example, a sale of substantially all of the assets of a passthrough entity is an acceleration event for an S corporation while that transaction, standing alone, is not an acceleration event for an electing corporation. The IRS and Treasury Department believe that it is appropriate to provide different acceleration rules for passthrough entities and electing corporations because the statute requires the debt instrument of a passthrough entity to be issued in connection with a trade or business. Accordingly, consistent with the trade or business requirement, it is appropriate to accelerate the deferred COD income of a passthrough entity if the entity sells substantially all of its assets.

A. Net Value Acceleration Rule

Under the net value acceleration rule, an electing corporation generally is required to accelerate all of its remaining deferred COD income if it engages in an impairment transaction, and immediately after the transaction, the value of its assets fails to satisfy a minimum threshold (as further described herein). In general, impairment transactions are volitional transactions that reduce an electing corporation's asset base.

As provided in these regulations, impairment transactions are any transactions, however effected, that impair an electing corporation's ability to pay the amount of Federal income tax liability on its deferred COD income and include, for example, distributions (including section 381(a) transactions), redemptions, below market sales, and donations, and the incurrence of additional indebtedness without a corresponding increase in asset value. However, value-for-value sales or exchanges (including, for example, an exchange to which section 351 or section 721 applies) are not impairment transactions. The IRS and Treasury Department believe that the receipt of replacement assets in these cases adequately protects the government's interests and ensures continued collectability of any incipient tax liability. Under this rule, an electing corporation's investments and expenditures in pursuance of its good faith business judgment are not impairment transactions, merely because, for example, acquired assets are riskier or less liquid than the electing corporation's previous assets. In addition, mere declines in the market value of an electing corporation's assets are not impairment transactions. Although the decline may impair an electing corporation's ability to pay its tax liability, a different rule would require continuous valuations and is contrary to the transactional approach taken in the statute and these regulations, and the realization requirement generally.

Under the net value acceleration rule, an electing corporation generally is required to accelerate its remaining deferred COD income if immediately after an impairment transaction, the gross value of the corporation's assets (gross asset value) is less than one hundred and ten percent of the sum of its total liabilities and the tax on the net amount of its deferred items (the net value floor). Solely for purposes of computing the net value floor, the tax on the net amount of the electing corporation's deferred items is determined by applying the highest rate of tax specified in section 11(b) for the taxable year (even though the corporation's actual tax rate for the taxable year may differ).

The net value acceleration rule has a mitigating provision that allows an electing corporation to avoid accelerated inclusion of its deferred COD income if value is restored to the corporation by the due date of the electing corporation's tax return (including extensions). In general, the amount required to be restored is the lesser of: (i) The amount of value that was removed (net of amounts previously restored under this rule) from the electing corporation in one or more impairment transactions; or (ii) the amount by which the electing corporation's net value floor exceeds its gross asset value. For example, assume an electing corporation incurs $50 of indebtedness, distributes the $50 of proceeds to its shareholder, and immediately after the distribution, the electing corporation's gross asset value is $25 below the net value floor. The electing corporation may avoid application of the net value acceleration rule if, as a result of a transaction, assets with a value of $25 are restored to the corporation before the due date of its tax return (including extensions) for the taxable year that includes the distribution. For purposes of this provision, the value that must be restored is determined at the time of the impairment transaction, and is determined upon a net value basis (for example, additional borrowings by an electing corporation do not restore value).

The IRS and Treasury Department believe that the net value acceleration rule is an appropriate interpretation of section 108(i) because, consistent with the purpose of facilitating workouts, the rule allows electing corporations the flexibility to realign business operations through strategic acquisitions and dispositions within the objective standard of the net value floor. Although the net value acceleration rule contains a valuation component, a valuation will be required only if an electing corporation engages in an impairment transaction. Moreover, the IRS and Treasury Department believe that the net value acceleration rule is a more objective rule than requiring corporations to determine the amount of business assets that would have to be retained simply to preserve the deferral benefit of section 108(i).

1. Consolidated Groups

In the case of consolidated groups, the determination of whether an electing corporation that is a member of a consolidated group (electing member) has engaged in an impairment transaction is made on a group-wide basis. Thus, an electing member is treated as engaging in an impairment transaction if any member's transaction impairs the group's ability to pay the tax liability associated with the group's deferred COD income. *See* § 1.1502–6. Accordingly, intercompany transactions are not impairment transactions. Similarly, the net value acceleration rule is applied by reference to the gross asset value of all members (excluding stock of members whether or not the stock is described in section 1504(a)(4)), the liabilities of all members, and the tax on all members' deferred items. For example, assume P is the common parent of the P–S consolidated group, S has a section 108(i) election in effect, and S makes a $100 distribution to P, which, on a separate entity basis, would reduce S's gross asset value below the net value floor. S's intercompany distribution to P is not an impairment transaction. However, if P makes a $100 distribution to its shareholder, P's distribution, subject to an exception described in section I.A.2 of this preamble, is an impairment transaction, and the net value acceleration rule is applied by reference to the assets, liabilities, and deferred items of the P–S group.

Special rules are provided when an electing member that previously engaged in an impairment transaction on a separate entity basis leaves a consolidated group. If the electing member ceases to be a member of a consolidated group, the cessation is treated as an impairment transaction and the net value acceleration rule is applied on a separate entity basis (by reference to the assets, liabilities, and deferred items of the electing member only) immediately after it ceases to be a member. If the electing member's gross asset value is less than the net value floor, then the electing member's remaining deferred COD income must be taken into account immediately before the electing member ceases to be a member (unless value is restored). In the case of an electing member that becomes a member of another consolidated group, the cessation is treated as an impairment transaction and the net value acceleration rule is applied by reference to the assets, liabilities, and deferred items of the members of the acquiring group immediately after the transaction. If the gross asset value of the acquiring group is less than its net value floor, the electing member's remaining deferred COD income is taken into account immediately before the electing member ceases to be a member of the former group. If accelerated inclusion is not required, the common parent of the acquiring group succeeds to the reporting requirements of section 108(i) with respect to the electing member.

2. Exception for Distributions and Charitable Contributions Consistent With Historical Practice—In General

The IRS and Treasury Department believe it is appropriate to allow an electing corporation to continue to make distributions to the extent the distributions are consistent with its historical practice. Accordingly, these distributions are not treated as impairment transactions (and are not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction). For this purpose, distributions are consistent with an electing corporation's historical practice to the extent the distributions are described in section 301(c) and the amount of these distributions, in the aggregate, for the applicable taxable year (applicable distribution amount) does not exceed the annual average amount of section 301(c) distributions over the preceding three taxable years (average distribution amount). Any excess of the applicable distribution amount over the average distribution amount is treated as an impairment transaction and is taken into account when applying the net value acceleration rule. For purposes of this rule, appropriate adjustments must be made to take into account any issuances or redemptions of stock, or similar transactions, occurring during a relevant taxable year. In addition, if the electing corporation has a short taxable year for the year of the distribution or for any of the years relied upon in computing the average distribution amount, the applicable distribution amount and the average distribution amount are determined on an annualized basis. If an electing corporation has been in existence for less than three years, the average distribution amount is computed by substituting the period during which the electing corporation has been in existence for the three preceding taxable years. The regulations also provide similar rules that exclude from impairment transaction status an electing corporation's charitable contributions (within the meaning of section 170(c)) that are consistent with its historical practice.

3. Special Rules for Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs)

In the case of a RIC or REIT, any distributions with respect to stock that are treated as a dividend under section 852 or 857 are not treated as impairment transactions (and are not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction). In addition, any redemption of a redeemable security, as defined in 15 U.S.C. section 80a–2(a)(32), by a RIC in the ordinary course of business is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

B. Other Mandatory Acceleration Events

1. Changes in Tax Status

To preserve the government's ability to collect the incipient tax liability associated with a C corporation's deferred COD income, these regulations provide that an electing corporation must take into account its remaining deferred COD income immediately before a change in its tax status. An example of such a change includes a C corporation that becomes a tax-exempt entity, or a C corporation that begins operating as a cooperative. Other changes in tax status are more fully described herein.

If a C corporation elects to be treated as an S corporation, the S corporation is subject to tax on its net recognized built-in gains during the recognition period. Section 1374(a). Although an item of income, such as deferred COD income, can constitute recognized built-in gain, recognition of the gain for any taxable year may be limited under § 1.1374–2. Accordingly, if an electing corporation elects to be treated as an S corporation, the S corporation would not pay tax on its deferred COD income to the extent that the S corporation's COD income and other recognized built-in gains exceed the limitation.

The IRS and Treasury Department have determined that permanent exclusion of a corporate tax liability associated with a section 108(i) election is inconsistent with congressional intent to provide for deferral of corporate tax liability with respect to COD income. Accordingly, these temporary regulations provide that if an electing corporation elects to become an S corporation, the C corporation must take into account its deferred COD income immediately before the S corporation election is effective.

Similarly, these temporary regulations provide that an electing corporation that elects to be treated as a RIC or REIT must take into account its remaining deferred COD income immediately before the election is effective.

2. Cessation of Existence

Section 108(i)(5)(D) provides that in the case of the cessation of business by a taxpayer, deferred items must be taken into account in the taxable year of the cessation. Consistent with this provision, in general, these temporary regulations provide that an electing corporation must accelerate its remaining deferred COD income in the taxable year that the corporation ceases to exist.

As noted in section I of the preamble, commentators suggested that continued deferral of an electing corporation's COD income is appropriate if the corporation ceases to exist in a reorganization or liquidation to which section 381(a) applies. The IRS and Treasury Department agree that, in these transactions, the policies that support nonrecognition for corporations also support continued deferral of COD income. In addition, an exception for these transactions affords corporations maximum flexibility in structuring transactions as asset reorganizations or stock reorganizations to meet business exigencies.

Therefore, these temporary regulations generally provide that if the assets of the electing corporation are acquired in a transaction to which section 381(a) applies (the section 381 exception), the electing corporation's deferred COD income is not accelerated. In such a case, the acquiring corporation succeeds to the electing corporation's remaining deferred COD income, and becomes subject to section 108(i), including all of its reporting requirements. However, these temporary regulations limit the applicability of the section 381 exception in certain circumstances, some of which are described herein. Moreover, a section 381(a) transaction may still constitute an impairment transaction. (*See* Example 3 of § 1.108(i)–1T(c)).

a. Outbound Section 381(a) Transactions

If the assets of a domestic electing corporation are acquired by a foreign corporation in a transaction to which section 381(a) applies, the electing corporation's deferred COD income may not be subject to U.S. tax when it is includible in the foreign acquirer's gross income. Accordingly, to ensure that the COD income is appropriately taxed, these temporary regulations provide that the electing corporation takes into account its remaining deferred COD income immediately before the transaction.

b. Inbound Section 381(a) Transactions

As more fully described in section III, in general, deferred COD income increases the earnings and profits of an electing corporation, including a foreign electing corporation, in the year the debt is discharged. Accordingly, if the assets of a foreign electing corporation are acquired by a domestic corporation in a transaction to which section 381(a) applies, the increase in earnings and profits is taken into account in computing the foreign corporation's all earnings and profits amount and therefore, may be subject to U.S. taxation as a deemed dividend pursuant to § 1.367(b)–3(b)(3). To prevent the deferred COD income from being subject to U.S. tax a second time when the deferred COD income is includible in the domestic acquirer's gross income, these temporary regulations provide that a foreign electing corporation takes into account its remaining deferred COD income immediately before the transaction if, as a result of the transaction, one or more exchanging shareholders include in income as a deemed dividend the all earnings and profits amount with respect to stock in the foreign electing corporation pursuant to § 1.367(b)–3(b)(3).

c. Acquisition of Assets of an Electing Corporation by a RIC or REIT or by an S Corporation

To ensure that the corporate tax liability associated with deferred COD income is appropriately preserved, these temporary regulations provide that if the assets of an electing corporation are acquired by a RIC or REIT in a transaction that is subject to § 1.337(d)–7 and section 381(a) (a conversion transaction), the electing corporation takes into account its remaining deferred COD income immediately before the conversion transaction. Similarly, if the assets of an electing C corporation are acquired by an S corporation in a transaction to which sections 1374(d)(8) and section 381(a) apply, the electing C corporation takes into account its remaining deferred COD income immediately before the transaction.

C. Title 11 (or Similar Case)

Under section 108(i)(5)(D), if an electing corporation ceases to do business, liquidates or sells substantially all of its assets in a proceeding under title 11 (or a similar case), the corporation's deferred items are taken into account the day before the petition is filed. The IRS and Treasury Department believe that the acceleration rules (outlined in section I) are sufficient to protect the collectability of tax relating to deferred COD income. Accordingly, no special acceleration rules for an electing corporation in a title 11 or similar case are provided.

II. Elective Acceleration for Electing Members of a Consolidated Group

These temporary regulations provide an elective provision under which an electing member of a consolidated group (other than the common parent) may at any time accelerate in full (and not in part) the inclusion of its remaining deferred COD income with respect to all applicable debt instruments. Elective acceleration within a consolidated group is consistent with other consolidated return provisions that mitigate the double taxation of income or gain.

III. Earnings and Profits

In Rev. Proc. 2009–37, the IRS and Treasury Department announced its intention to issue regulations regarding the computation of a corporation's earnings and profits in connection with an election under section 108(i). *See* § 601.601(d)(2)(ii)(*b*). Consistent with the revenue procedure, these temporary regulations provide that deferred COD income generally increases earnings and profits in the taxable year that it is realized, and deferred OID deductions generally decrease earnings and profits in the taxable year or years in which the deductions would be allowed without regard to the deferral rules of section 108(i).

Although § 1.312–6(a) generally states that adjustments to earnings and profits are dependent upon the method of accounting properly employed in computing taxable income (or net income, as the case may be), the IRS and Treasury Department believe this principle should not apply in the case of an electing corporation.

Section 312(n)(5) provides that in the case of any installment sale, earnings and profits shall be computed as if the corporation did not use the installment sale method. Some commentators have suggested that because the deferral of COD income under section 108(i) is analogous to the deferral of gain from an installment sale, a rule consistent with section 312(n)(5) should apply for purposes of determining the timing of adjustments to earnings and profits with respect to deferred items under section 108(i). The IRS and Treasury Department agree that the policies underlying section 312(n) inform the treatment of deferred COD income under section 108(i).

The legislative history to section 312(n)(5) focuses on the fact that a taxpayer may realize cash or its equivalent under the installment method in the year of the sale, but is not required to take income into account until later years. *S. Rep. No. 98–169, at 198–99 (1984*). As in the case of an installment sale, an electing corporation realizes economic income in the year of discharge. Even though the electing corporation is not required to recognize income until later years, its dividend paying capacity is enhanced immediately, not during the inclusion period, or at the time the deferred COD income may be accelerated into income.

These temporary regulations also provide certain exceptions to current year adjustments to earnings and profits. In the case of RICs and REITs, deferred COD income increases earnings and profits in the taxable year or years in which the deferred COD income is includible in gross income and not in the year that the deferred COD income is realized, and deferred OID deductions decrease earnings and profits in the taxable year or years that the deferred OID deductions are deductible. This rule is intended to ensure that a RIC or REIT has sufficient earnings and profits to claim a dividends paid deduction in the taxable year that the deferred COD income is included in taxable income. In addition, for purposes of calculating alternative minimum taxable income, deferred items increase or decrease, as the case may be, adjusted current earnings under section 56(g)(4) in the taxable year or years that the item is includible or deductible.

IV. Deferred OID Deductions

Section 108(i)(2) generally provides that if, as part of a reacquisition to which section 108(i)(1) applies, a debt instrument is issued (or is treated as issued under section 108(e)(4)) for the applicable debt instrument being reacquired and there is any OID with respect to the debt instrument, no deduction otherwise allowable is allowed for the portion of the OID that accrues before the inclusion period and that does not exceed the COD income with respect to the applicable debt instrument being reacquired. The aggregate amount of deferred OID deductions is allowed ratably over the inclusion period. If the amount of OID accruing before the inclusion period exceeds the deferred COD income with respect to the applicable debt instrument being reacquired, the deductions are disallowed in the order in which the OID is accrued.

Under section 108(i)(2)(B), if a debt instrument is issued by an issuer and the proceeds of the debt instrument are used directly or indirectly by the issuer to reacquire an applicable debt instrument of the issuer, then the debt instrument is treated as issued for the applicable debt instrument being reacquired. If only a portion of the proceeds of the debt instrument are used directly or indirectly to reacquire the applicable debt instrument, then the rules in section 108(i)(2)(A) apply to the portion of any OID on the debt instrument that is equal to the portion of the proceeds used to reacquire the applicable debt instrument.

A. Application of § 1.1502–13(g)(5)

The intercompany obligation rules of § 1.1502–13(g) operate to minimize the effect on consolidated taxable income of items of income, gain, deduction, or loss arising from intercompany debt. These rules generally match the amount, timing, and character of the creditor and debtor member's items, and ensure that future items similarly correspond. Thus, for example, assume that S holds a B note with an adjusted issue price and basis of $100 and a fair market value of $70, and that S sells the B note to a nonmember for $70. Under § 1.1502–13(g)(3), B is deemed, immediately before the sale to X, to satisfy the note for its fair market value of $70, resulting in $30 of COD income for B and $30 of loss for S (which is treated as ordinary loss under the attribute redetermination rule of § 1.1502–13(c)(4)(i)). Because the debtor's COD income matches the creditor's ordinary loss, in cases where the intercompany obligation becomes a non-intercompany obligation (and in intragroup transactions), there is no benefit to the group to elect deferral of COD income under section 108(i).

However, for those transactions in which a non-intercompany obligation becomes an intercompany obligation (as described in § 1.1502–13(g)(5)), the timing and attributes of the debtor and creditor member's items from the deemed satisfaction are determined on a separate entity basis. In such cases, the elective deferral rules of section 108(i) may be beneficial. Accordingly, these temporary regulations limit the application of section 108(i) by providing that in the case of an intercompany obligation (as defined in § 1.1502–13(g)(2)(ii)), the term *applicable debt instrument* includes only a debt instrument for which COD income is realized upon the debt instrument's deemed satisfaction under § 1.1502–13(g)(5).

B. Deemed Debt-for-Debt Exchanges

Pursuant to the regulatory authority in section 108(i)(7), the temporary regulations provide that, for purposes of section 108(i)(2) (relating to deferred

OID deductions that arise in certain debt-for-debt exchanges involving the reacquisition of an applicable debt instrument), if the proceeds of any debt instrument are used directly or indirectly by the issuer or a person related to the issuer (within the meaning of section 108(i)(5)(A)) to reacquire an applicable debt instrument, the debt instrument shall be treated as issued for the applicable debt instrument being reacquired. Therefore, section 108(i)(2) may apply, for example, to a debt instrument issued by a corporation for cash in which some or all of the proceeds are used directly or indirectly by the corporation's related subsidiary in the reacquisition of the subsidiary's applicable debt instrument. The rule in the temporary regulations is intended to prevent related parties from avoiding the rules for deferred OID deductions.

C. Directly or Indirectly

In response to comments received by the IRS and Treasury Department, the temporary regulations provide principles similar to those of § 1.279–3(b) for purposes of determining when the proceeds of a debt instrument will be treated as having been used "directly or indirectly" to reacquire an applicable debt instrument. Generally, whether the proceeds from an issuance of a debt instrument are used directly or indirectly by the issuer of the debt instrument or a person related to the issuer to reacquire an applicable debt instrument will depend upon all of the facts and circumstances surrounding the issuance and the reacquisition. The proceeds of an issuance of a debt instrument will be treated as being used indirectly to reacquire an applicable debt instrument if: (i) At the time of the issuance of the debt instrument, the issuer of the debt instrument anticipated that an applicable debt instrument of the issuer or a person related to the issuer would be reacquired by the issuer, and the debt instrument would not have been issued if the issuer had not so anticipated such reacquisition; (ii) at the time of the issuance of the debt instrument, the issuer of the debt instrument or a person related to the issuer anticipated that an applicable debt instrument would be reacquired by a related person and the related person receives cash or property that it would not have received unless the reacquisition had been so anticipated; or (iii) at the time of the reacquisition, the issuer or a person related to the issuer foresaw or reasonably should have foreseen that it would be required to issue a debt instrument, which it would not have otherwise been required to issue if the reacquisition had not occurred, in order to meet its future economic needs.

D. Proportional Rule for Accruals of OID

If a portion of the proceeds of a debt instrument with OID are used directly or indirectly to reacquire an applicable debt instrument, then the temporary regulations provide that the amount of the issuer's deferred OID deductions generally is equal to the product of the amount of OID that accrues in the taxable year under section 1272 or section 1275 (and the regulations under those sections), whichever section is applicable, and a fraction, the numerator of which is the portion of the total proceeds of the debt instrument used directly or indirectly to reacquire the applicable debt instrument and the denominator of which is the total proceeds of the debt instrument. However, if the total amount of OID that accrues before the inclusion period is greater than the total amount of deferred COD income under section 108(i), then the OID deductions are disallowed in the order in which the OID is accrued, subject to the total amount of deferred COD income.

E. Acceleration Events for Deferred OID Deductions

The temporary regulations provide rules for the acceleration of deferred OID deductions by an issuer that is a C corporation (C corporation issuer). The IRS and Treasury Department believe that it is appropriate to accelerate deferred OID deductions with respect to a debt instrument when the corresponding deferred COD income is taken into account. Accordingly, these temporary regulations provide that all or a portion of a C corporation issuer's deferred OID deductions with respect to a debt instrument are taken into account to the extent that an electing entity or its owners include all or a portion of the deferred COD income to which the C corporation issuer's deferred OID deductions relate.

These temporary regulations also include special rules to accelerate a C corporation issuer's remaining deferred OID deductions even though the deferred COD income to which it relates continues to be deferred. Under these rules, a C corporation issuer takes into account all of its remaining deferred OID deductions if the issuer (i) changes its tax status, or (ii) ceases to exist in a transaction to which section 381(a) does not apply, taking into account the application of § 1.1502–34. *See* § 1.1502–80(g).

With respect to all taxpayers with deferred OID deductions, the temporary regulations also provide that any remaining deferred OID deductions are not accelerated solely by reason of the retirement of any debt instrument subject to section 108(i)(2).

V. Effective/Applicability Dates

In general, the rules regarding deferred COD income and the calculation of earnings and profits apply to reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008. In addition, the rules regarding deferred OID deductions generally apply to debt instruments issued after December 31, 2008 in connection with the reacquisition of an applicable debt instrument.

However, the rules with respect to the acceleration of deferred COD income and deferred OID deductions apply prospectively to acceleration events occurring on or after August 11, 2010. Electing corporations and C corporation issuers are given the option to apply these rules to all acceleration events occurring prior to August 11, 2010 by taking a return position consistent with these provisions. In the case of a consolidated group, this option is available only if the acceleration rules are applied to all acceleration events with respect to all members of the group. In addition, certain transitional rules are provided in order to allow electing corporations the ability to use provisions in the acceleration rules that are time sensitive.

To the extent an electing corporation or C corporation issuer does not apply these acceleration rules to acceleration events occurring prior to August 11, 2010, then all deferred items are subject to the rules of section 108(i)(5)(D)(i).

Comments

The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**. Please *see* the "Comments and Requests for a Public Hearing" section of the notice of proposed rulemaking for the procedures to follow in submitting comments on the proposed regulations on this subject.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-referenced notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register.** Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Section 108(i) applies to the reacquisition of an applicable debt instrument during the brief election period, January 1, 2009 through December 31, 2010. These temporary regulations provide necessary guidance regarding the application of this new section 108(i) in order for corporations to timely file their tax returns. For this reason, it has been determined pursuant to 5 U.S.C. 553(b)(3)(B), that prior notice and public procedure are impracticable and contrary to the public interest. For the same reason, it has been determined pursuant to 5 U.S.C. 553(d)(3) that good cause exists for not delaying the effective date of these temporary regulations.

Drafting Information

The principal authors of these regulations are Robert M. Rhyne and Rubin B. Ranat of the Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding the entry for § 1.108(i)–0T, § 1.108(i)–1T, and § 1.108(i)–3T, to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.108(i)–0T also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

Section 1.108(i)–1T also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

Section 1.108(i)–3T also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

■ **Par. 2.** Section 1.108(i)–0T is added to read as follows:

§ 1.108(i)–0T Definitions (temporary).

(a) *Definitions.* For purposes of regulations under section 108(i)—

(1) *Acquisition.* An *acquisition,* with respect to any applicable debt instrument, includes an acquisition of the debt instrument for cash or other property, the exchange of the debt instrument for another debt instrument (including an exchange resulting from a modification of the debt instrument), the exchange of the debt instrument for corporate stock or a partnership interest, the contribution of the debt instrument to capital, the complete forgiveness of the indebtedness by the holder of the debt instrument, and a direct or an indirect acquisition within the meaning of § 1.108–2;

(2) *Applicable debt instrument.* An *applicable debt instrument* is a debt instrument that was issued by a C corporation or any other person in connection with the conduct of a trade or business by such person. In the case of an intercompany obligation (as defined in § 1.1502–13(g)(2)(ii)), *applicable debt instrument* includes only an instrument for which COD income is realized upon the instrument's deemed satisfaction under § 1.1502–13(g)(5);

(3) *C corporation issuer. C corporation issuer* means a C corporation that issues a debt instrument with any deferred OID deduction;

(4) *C corporation partner.* A *C corporation partner* is a C corporation that is a direct or indirect partner of an electing partnership or a related partnership;

(5) *COD income. COD income* means income from the discharge of indebtedness, as determined under sections 61(a)(12) and 108(a) and the regulations under those sections;

(6) *COD income amount.* A *COD income amount* is a partner's distributive share of COD income with respect to an applicable debt instrument of an electing partnership;

(7) *Debt instrument. Debt instrument* means a bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness (within the meaning of section 1275(a)(1));

(8) *Deferral period.* For a reacquisition that occurs in 2009, *deferral period* means the taxable year of the reacquisition and the four taxable years following such taxable year. For a reacquisition that occurs in 2010, *deferral period* means the taxable year of the reacquisition and the three taxable years following such taxable year;

(9) *Deferred amount.* A *deferred amount* is the portion of a partner's COD income amount with respect to an applicable debt instrument that is deferred under section 108(i);

(10) *Deferred COD income. Deferred COD income* means COD income that is deferred under section 108(i);

(11) *Deferred item.* A *deferred item* is any item of deferred COD income or deferred OID deduction that has not been previously taken into account under section 108(i);

(12) *Deferred OID deduction.* A *deferred OID deduction* means an otherwise allowable deduction for OID that is deferred under section 108(i)(2) with respect to a debt instrument issued (or treated as issued under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)–3T(a);

(13) *Deferred section 465 amount.* A *deferred section 465 amount* is described in paragraph (d)(3) of § 1.108(i)–2T;

(14) *Deferred section 752 amount.* A *deferred section 752 amount* is described in paragraph (b)(3) of § 1.108(i)–2T;

(15) *Direct partner.* A *direct partner* is a person that owns a direct interest in a partnership;

(16) *Electing corporation.* An *electing corporation* is a C corporation with deferred COD income by reason of a section 108(i) election;

(17) *Electing entity.* An *electing entity* is an entity that is a taxpayer that makes an election under section 108(i);

(18) *Electing member.* An *electing member* is an electing corporation that is a member of an affiliated group that files a consolidated return;

(19) *Electing partnership.* An *electing partnership* is a partnership that makes an election under section 108(i);

(20) *Electing S corporation.* An *electing S corporation* is an S corporation that makes an election under section 108(i);

(21) *Included amount.* An *included amount* is the portion of a partner's COD income amount with respect to an applicable debt instrument that is not deferred under section 108(i) and is included in the partner's distributive share of partnership income for the taxable year of the partnership in which the reacquisition occurs;

(22) *Inclusion period.* The *inclusion period* is the five taxable years following the last taxable year of the deferral period;

(23) *Indirect partner.* An *indirect partner* is a person that owns an interest in a partnership through an S corporation and/or one or more partnerships;

(24) *Issuing entity.* An *issuing entity* is any entity that is—

(i) A related partnership;

(ii) A related S corporation;

(iii) An electing partnership that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)–3T(a); or

(iv) An electing S corporation that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)–3T(a);

(25) *OID. OID* means original issue discount, as determined under sections 1271 through 1275 (and the regulations under those sections). If the amount of OID with respect to a debt instrument is less than a de minimis amount as determined under § 1.1273–1(d), the OID is treated as zero for purposes of section 108(i)(2);

(26) *Reacquisition.* A *reacquisition,* with respect to any applicable debt instrument, is any event occurring after December 31, 2008 and before January 1, 2011, that causes COD income with respect to such applicable debt instrument, including any acquisition of the debt instrument by the debtor that issued (or is otherwise the obligor under) the debt instrument or a person related to such debtor (within the meaning of section 108(i)(5)(A));

(27) *Related partnership.* A *related partnership* is a partnership that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)–3T(a);

(28) *Related S corporation.* A *related S corporation* is an S corporation that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)–3T(a);

(29) *Separate interest.* A *separate interest* is a direct interest in an electing partnership or in a partnership or S corporation that is a direct or indirect partner of an electing partnership;

(30) *S corporation partner.* An *S corporation partner* is an S corporation that is a direct or indirect partner of an electing partnership or a related partnership.

(b) *Effective/Applicability dates*—(1) *In general.* This section, § 1.108(i)–2T, and, except as provided in paragraph (b)(2) of this section, § 1.108(i)–1T apply to reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008. In addition, § 1.108(i)–3T applies to debt instruments issued after December 31, 2008, in connection with reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008.

(2) *Acceleration events*—(i) *In general.* Section 1.108(i)–1T(b) (acceleration rules) generally applies to acceleration events occurring on or after August 11, 2010 However, an electing corporation or C corporation issuer may apply the acceleration rules to all acceleration events occurring prior to August 11, 2010 by taking a return position consistent with these provisions beginning with the first acceleration event occurring prior to August 11, 2010. Also, in the case of a consolidated group, if the common parent of the consolidated group applies the acceleration rules on behalf of one member of the consolidated group, then the common parent must apply the acceleration rules to all acceleration events with respect to all members of the group. If the electing corporation, common parent (under the preceding sentence), or C corporation issuer, as the case may be, does not apply the acceleration rules to all acceleration events occurring prior to August 11, 2010, then it is, with respect to all deferred items, subject to the rules of section 108(i)(5)(D)(i).

(3) *Transitional rules*—(i) *Net value acceleration rule and corrective action to restore net value rule.* If an electing corporation applies the acceleration rules of § 1.108(i)–1T(b) to all acceleration events occurring prior to August 11, 2010 and the due date of its tax return (including extensions) for the taxable year of the mandatory acceleration event occurs prior to August 11, 2010, then for purposes of the net value acceleration rule described in § 1.108(i)–1T(b)(2)(iii), an electing corporation may restore value by the fifteenth day of the ninth month following August 11, 2010.

(ii) *Elective acceleration.* If an electing member cannot timely file an election under § 1.108(i)–1T(b)(3) to accelerate its remaining deferred COD income by the due date of the electing member's tax return (including extensions) which occurs prior to August 11, 2010, then an amended return must be filed with the required information statement by the fifteenth day of the ninth month following August 11, 2010.

■ **Par. 3.** Section 1.108(i)–1T is added to read as follows:

§ 1.108(i)–1T Deferred discharge of indebtedness income and deferred original issue discount deductions of C corporations (temporary).

(a) *Overview.* Section 108(i)(1) provides an election for the deferral of COD income arising in connection with the reacquisition of an applicable debt instrument. An electing corporation generally includes deferred COD income ratably over the inclusion period. Paragraph (b) of this section provides rules for the mandatory acceleration of an electing corporation's remaining deferred COD income, the mandatory acceleration of a C corporation issuer's deferred OID deductions, and for the elective acceleration of an electing member's (other than the common parent's) remaining deferred COD income. Paragraph (c) of this section provides examples illustrating the application of the mandatory and elective acceleration rules. Paragraph (d) of this section provides rules for the computation of an electing corporation's earnings and profits. Paragraph (e) of this section refers to the effective/applicability dates.

(b) *Acceleration events*—(1) *Deferred COD income.* Except as otherwise provided in paragraphs (b)(2) and (3) of this section, and § 1.108(i)–2T(b)(6) (in the case of a corporate partner), an electing corporation's deferred COD income is taken into account ratably over the inclusion period.

(2) *Mandatory acceleration events.* An electing corporation takes into account all of its remaining deferred COD income, including its share of an electing partnership's deferred COD income, immediately before the occurrence of any one of the events described in this paragraph (b)(2) (mandatory acceleration events).

(i) *Changes in tax status.* The electing corporation changes its tax status. For purposes of the preceding sentence, an electing corporation is treated as changing its tax status if it becomes one of the following entities:

(A) A tax-exempt entity as defined in § 1.337(d)–4(c)(2).

(B) An S corporation as defined in section 1361(a)(1).

(C) A qualified subchapter S subsidiary as defined in section 1361(b)(3)(B).

(D) An entity operating on a cooperative basis within the meaning of section 1381.

(E) A regulated investment company (RIC) as defined in section 851 or a real estate investment trust (REIT) as defined in section 856.

(F) A qualified REIT subsidiary as defined in section 856(i), but only if the qualified REIT subsidiary was not a

REIT immediately before it became a qualified REIT subsidiary.

(ii) *Cessation of corporate existence*—(A) *In general.* The electing corporation ceases to exist for Federal income tax purposes.

(B) *Exception for section 381(a) transactions*—(*1*) *In general.* The electing corporation is not treated as ceasing to exist and is not required to take into account its remaining deferred COD income solely because its assets are acquired in a transaction to which section 381(a) applies. In such a case, the acquiring corporation succeeds to the electing corporation's remaining deferred COD income and becomes subject to section 108(i) and the regulations thereunder, including all reporting requirements, as if the acquiring corporation were the electing corporation. A transaction is not treated as one to which section 381(a) applies for purposes of this paragraph (b)(2)(ii)(B) in any one of the following circumstances:

(*i*) The acquisition of the assets of an electing corporation by an S corporation, if the acquisition is described in section 1374(d)(8).

(*ii*) The acquisition of the assets of an electing corporation by a RIC or REIT, if the acquisition is described in § 1.337(d)–7(a)(2)(ii).

(*iii*) The acquisition of the assets of a domestic electing corporation by a foreign corporation.

(*iv*) The acquisition of the assets of a foreign electing corporation by a domestic corporation, if as a result of the transaction, one or more exchanging shareholders include in income as a deemed dividend all the earnings and profits amount with respect to stock in the foreign electing corporation pursuant to § 1.367(b)–3(b)(3).

(*v*) The acquisition of the assets of an electing corporation by a tax-exempt entity as defined in § 1.337(d)–4(c)(2).

(*vi*) The acquisition of the assets of an electing corporation by an entity operating on a cooperative basis within the meaning of section 1381.

(*2*) *Special rules for consolidated groups*—(*i*) *Liquidations.* For purposes of paragraph (b)(2)(ii)(B) of this section, the acquisition of assets by distributee members of a consolidated group upon the liquidation of an electing corporation is not treated as a transaction to which section 381(a) applies, unless immediately prior to the liquidation, one of the distributee members owns stock in the electing corporation meeting the requirements of section 1504(a)(2) (without regard to § 1.1502–34). *See* § 1.1502–80(g).

(*ii*) *Taxable years.* In the case of an intercompany transaction to which section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(iii) *Net value acceleration rule*—(A) *In general.* The electing corporation engages in an impairment transaction and, immediately after the transaction, the gross value of the electing corporation's assets (gross asset value) is less than one hundred and ten percent of the sum of its total liabilities and the tax on the net amount of its deferred items (the net value floor) (the net value acceleration rule). Impairment transactions are any transactions, however effected, that impair an electing corporation's ability to pay the amount of Federal income tax liability on its deferred COD income and include, for example, distributions (including section 381(a) transactions), redemptions, below-market sales, charitable contributions, and the incurrence of additional indebtedness without a corresponding increase in asset value. Value-for-value sales or exchanges (for example, an exchange to which section 351 or section 721 applies), or mere declines in the market value of the electing corporation's assets are not impairment transactions. In addition, an electing corporation's investments and expenditures in pursuance of its good faith business judgment are not impairment transactions. For purposes of determining an electing corporation's gross asset value, the amount of any distribution that is not treated as an impairment transaction under paragraph (b)(2)(iii)(D) of this section (distribution consistent with historical practice) or under paragraph (b)(2)(iii)(E) of this section (special rules for RICs and REITs) is treated as an asset of the electing corporation. Solely for purposes of computing the amount of the net value floor, the tax on the deferred items is determined by applying the highest rate of tax specified in section 11(b) for the taxable year.

(B) *Transactions integrated.* Any transaction that occurs before the reacquisition of an applicable debt instrument, but that occurs pursuant to the same plan as the reacquisition, is taken into account in determining whether the gross asset value of the electing corporation is less than the net value floor.

(C) *Corrective action to restore net value.* An electing corporation is not required to take into account its deferred COD income under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section if, before the due date of the electing corporation's return (including extensions), value is restored in a transaction in an amount equal to the lesser of—

(*1*) The amount of value that was removed from the electing corporation in one or more impairment transactions (net of amounts previously restored under this paragraph (b)(2)(iii)(C)); or

(*2*) The amount by which the electing corporation's net value floor exceeds its gross asset value. For purposes of this paragraph (b)(2)(iii)(C), for example, assume an electing corporation incurs $50 of debt, distributes the $50 of proceeds to its shareholder, and immediately after the distribution, the electing corporation's gross asset value is below the net value floor by $25. The electing corporation may avoid the inclusion of its remaining deferred COD income if value of at least $25 is restored to it before the due date of the electing corporation's tax return (including extensions) for the taxable year that includes the distribution. The value that must be restored is determined at the time of the impairment transaction on a net value basis (for example, additional borrowings by an electing corporation do not restore value).

(D) *Exceptions for distributions and charitable contributions that are consistent with historical practice.* An electing corporation's distributions are not treated as impairment transactions (and are not taken into account as a reduction of the electing corporation's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the distributions are described in section 301(c) and the amount of these distributions, in the aggregate, for the applicable taxable year (applicable distribution amount) does not exceed the annual average amount of section 301(c) distributions over the preceding three taxable years (average distribution amount). If an electing corporation's applicable distribution amount exceeds its average distribution amount (excess amount), then the amount of the impairment transaction equals the excess amount. Appropriate adjustments must be made to take into account any issuances or redemptions of stock, or similar transactions, occurring during the year of distribution or any of the three preceding years. If the electing corporation has a short taxable year for the year of the distribution or for any of the three preceding years, the amounts are determined on an annualized basis. If an electing corporation has been in existence for less than three years, the period during which the electing corporation has been in existence is substituted for the three preceding taxable years. For purposes of determining an electing corporation's average distribution amount, the electing corporation does not take into account the distribution history of a distributor or transferor in a transaction to which section 381(a) applies (other than a transaction described in section 368(a)(1)(F)). Rules similar to those prescribed in this paragraph (b)(2)(iii)(D) also apply to an electing corporation's charitable contributions (within the meaning of section 170(c)) that are consistent with its historical practice.

(E) *Special rules for RICs and REITs*—(*1*) *Distributions.* Notwithstanding paragraph (b)(2)(iii)(D) of this section, in the case of a RIC or REIT, any distribution with respect to stock that is treated as a dividend under section 852 or 857 is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(*2*) *Redemptions by RICs.* Any redemption of a redeemable security, as defined in 15 U.S.C. section 80a–2(a)(32), by a RIC in the ordinary course of business is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(F) *Special rules for consolidated groups*—(*1*) *Impairment transactions and net value acceleration rule.* In the case of an electing member, the determination of whether the member has engaged in an impairment transaction is made on a group-wide basis. An electing member is treated as engaging in an impairment transaction if any member's transaction impairs the group's ability to pay the tax liability associated with all electing members' deferred COD income. Accordingly, intercompany transactions are not impairment transactions. Similarly, the net value acceleration rule is applied by reference to the gross asset value of all members (excluding stock of members whether or not described in section 1504(a)(4)), the liabilities of all members, and the tax on all members' deferred items. For example, assume P is the common parent of the P–S consolidated group, S has a section 108(i) election in effect, and S makes a $100 distribution to P which, on a separate entity basis, would reduce S's gross asset value below the net value floor. S's intercompany distribution to P is not an impairment transaction. However, if P makes a $100 distribution to its shareholder, P's distribution is an impairment transaction (unless the distribution is consistent with its historical practice under paragraph (b)(2)(iii)(D) of this section), and the net value acceleration rule is applied by reference to the assets, liabilities, and deferred items of the P–S group.

(*2*) *Departing member.* If an electing member that previously engaged in one or more impairment transactions on a separate entity basis ceases to be a member of a consolidated group (departing member), the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A) of this section is applied to the departing member on a separate entity basis immediately after ceasing to be a member (and taking into account the impairment transaction(s) that occurred on a separate entity basis). If the departing member's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's deferred COD income is not accelerated, the departing member is subject to the reporting requirements of section 108(i) on a separate entity basis. If the departing member becomes a member of another consolidated group, the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A) of this section is applied by reference to the assets, liabilities, and the tax on deferred items of the members of the acquiring group immediately after the transaction. If the acquiring group's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's remaining deferred COD income is not accelerated, the common parent of the acquiring group succeeds to the reporting requirements of section 108(i) with respect to the departing member.

(3) *Elective acceleration for certain consolidated group members*—(i) *In general.* An electing member (other than the common parent) of a consolidated group may elect at any time to accelerate in full (and not in part) the inclusion of its remaining deferred COD income with respect to all applicable debt instruments by filing a statement described in paragraph (b)(3)(ii) of this section. Once made, an election to accelerate deferred COD income under this paragraph (b)(3) is irrevocable.

(ii) *Time and manner for making election*—(A) *In general.* The election to accelerate the inclusion of an electing member's remaining deferred COD income with respect to all applicable debt instruments is made on a statement attached to a timely filed tax return (including extensions) for the year in which the deferred COD income is taken into account. The election is made by the common parent on behalf of the electing member. *See* § 1.1502–77(a).

(B) *Additional information.* The statement must include—

(*1*) *Label.* A label entitled "SECTION 1.108(i)–1T ELECTION AND INFORMATION STATEMENT BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF THE ELECTING MEMBER]"; and

(*2*) *Required information.* An identification of each applicable debt instrument to which an election under this paragraph (b)(3) applies and the corresponding amount of—

(*i*) Deferred COD income that is accelerated under this paragraph (b)(3); and

(*ii*) Deferred OID deductions that are accelerated under paragraph (b)(4) of this section.

(4) *Deferred OID deductions*—(i) *In general.* Except as otherwise provided in paragraph (b)(4)(ii) of this section and § 1.108(i)–2T(b)(6) (in the case of a C corporation partner), a C corporation issuer's deferred OID deductions are taken into account ratably over the inclusion period.

(ii) *OID acceleration events.* A C corporation issuer takes into account all of its remaining deferred OID deductions with respect to a debt instrument immediately before the occurrence of any one of the events described in this paragraph (b)(4)(ii).

(A) *Inclusion of deferred COD income.* An electing entity or its owners take into account all of the remaining deferred COD income to which the C corporation issuer's deferred OID deductions relate. If, under § 1.108(i)–2T(b) or (c), an electing entity or its owners take into account only a portion of the deferred COD income to which the deferred OID deductions relate, then the C corporation issuer takes into account a proportionate amount of the remaining deferred OID deductions.

(B) *Changes in tax status.* The C corporation issuer changes its tax status within the meaning of paragraph (b)(2)(i) of this section.

(C) *Cessation of corporate existence*—(*1*) *In general.* The C corporation issuer ceases to exist for Federal income tax purposes.

(*2*) *Exception for section 381(a) transactions*—(*i*) *In general.* A C corporation issuer is not treated as ceasing to exist and does not take into account its remaining deferred OID deductions in a transaction to which section 381(a) applies, taking into account the application of § 1.1502–34, as appropriate. *See* § 1.1502–80(g). This exception does not apply to a transaction which is not treated as one to which section 381(a) applies under paragraph (b)(2)(iii)(B)(*1*) of this section.

(*ii*) *Taxable years.* In the case of an intercompany transaction to which section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(c) *Examples.* The application of this section is illustrated by the following examples. Unless otherwise stated, P, S, S1, and X are domestic C corporations, and each files a separate return on a calendar year basis:

Example 1. Net value acceleration rule. (i) *Facts.* On January 1, 2009, S reacquires its own note and realizes $400 of COD income. Pursuant to an election under section 108(i), S defers recognition of the entire $400 of COD income. Therefore, absent a mandatory acceleration event, S will take into account $80 of its deferred COD income in each year of the inclusion period. On December 31, 2010, S makes a $25 distribution to its sole shareholder, P, and this is the only distribution made by S in the past four years. Immediately following the distribution, S's gross asset value is $100, S has no liabilities, and the Federal income tax on S's $400 of deferred COD income is $140. Accordingly, S's net value floor is $154 (110% × $140).

(ii) *Analysis.* Under paragraph (b)(2)(iii)(A) of this section, S's distribution is an impairment transaction. Immediately following the distribution, S's gross asset value of $100 is less than the net value floor of $154. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S takes into account its $400 of deferred COD income immediately before the distribution.

(iii) *Corrective action to restore value.* The facts are the same as in paragraph (i) of this *Example 1,* except that P contributes assets with a value of $25 to S before the due date of S's 2010 return (including extensions). Because P restores $25 of value to S (the lesser of the amount of value removed in the distribution ($25) or the amount by which S's net value floor exceeds its gross asset value ($54)), under paragraph (b)(2)(iii)(C) of this section, S does not take into account its $400 of deferred COD income.

Example 2. Distributions consistent with historical practice. (i) *Facts.* P, a publicly traded corporation, makes a valid section 108(i) election with respect to COD income realized in 2009. On December 31, 2009, P distributes $25 million on its 5 million shares of common stock outstanding. As of January 1, 2006, P has 10 million shares of common stock outstanding, and on March 31, 2006, P distributes $10 million on those 10 million shares. On September 15, 2006, P effects a 2:1 reverse stock split, and on December 31, 2006, P distributes $10 million on its 5 million shares of common stock outstanding. In each of 2007 and 2008, P distributes $5 million on its 5 million shares of common stock outstanding. All of the distributions are described in section 301(c).

(ii) *Amount of impairment transaction.* Under paragraph (b)(2)(iii)(D) of this section, P's 2009 distributions are not treated as impairment transactions (and are not taken into account as a reduction of P's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the aggregate amount distributed in 2009 (the applicable distribution amount) does not exceed the annual average amount of distributions (the average distribution amount) over the preceding three taxable years. Accordingly, P's applicable distribution amount for 2009 is $25 million, and its average distribution amount is $10 million ($20 million (2006) plus $5 million (2007) plus $5 million (2008) divided by 3). The reverse stock split in 2006 is not a transaction requiring an adjustment to the determination of the average distribution amount. Because P's applicable distribution amount of $25 million exceeds its average distribution amount of $10 million, under paragraph (b)(2)(iii)(D) of this section, the amount of P's 2009 distribution that is treated as an impairment transaction is $15 million. The balance of the 2009 distribution, $10 million, is not treated as an impairment transaction (and is not taken into account as a reduction in P's gross asset value when applying the net value acceleration rule to any impairment transaction).

(iii) *Distribution history.* The facts are the same as in paragraph (i) of this *Example 2,* except that in 2010, P merges into X in a transaction to which section 381(a) applies, with X succeeding to P's deferred COD income, and X makes a distribution to its shareholders. For purposes of determining whether X's distribution is consistent with its historical practice, the average distribution amount is determined solely with respect to X's distribution history.

Example 3. Cessation of corporate existence. (i) *Transaction to which section 381(a) applies.* P owns all of the stock of S. In 2009, S reacquires its own note and elects to defer recognition of its $400 of COD income under section 108(i). On December 31, 2010, S liquidates into P in a transaction that qualifies under section 332. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A) of this section, S's distribution to P is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor) immediately following the distribution. If S's deferred COD income is not taken into account under the net value acceleration rule of (b)(2)(iii) of this section, P succeeds to S's remaining deferred COD income and to S's reporting requirements as if P were the electing corporation.

(ii) *Debt-laden distributee.* The facts are the same as in paragraph (i) of this *Example 3,* except that in the liquidation, S distributes $100 of assets to P, a holding company whose only asset is its stock in S. Assume that immediately following the distribution, P's gross asset value is $100, P has $60 of liabilities, and the Federal income tax on the $400 of deferred COD income is $140. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A) of this section, S's distribution to X is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor). Immediately following the distribution, P's gross asset value of $100 is less than the net value floor of $220 [110% × ($60 + $140)]. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S is required to take into account its $400 of deferred COD income immediately before the distribution, unless value is restored to P pursuant to (b)(2)(iii)(C) of this section.

(iii) *Foreign acquirer.* The facts are the same as in paragraph (i) of this *Example 3,* except that P is a foreign corporation. Although S's assets are acquired in a transaction to which section 381(a) applies, under paragraph (b)(2)(ii)(B)(*1*)(*iii*) of this section, the exception to accelerated inclusion does not apply and S takes into account its remaining deferred COD income immediately before the liquidation. *See* also section 367(e)(2) and the regulations thereunder.

(iv) *Section 338 transaction.* P, the common parent of a consolidated group (P group), owns all the stock of S1, one of the members of the P group. In 2009, S1 reacquires its own indebtedness and realizes $30 of COD income. Pursuant to an election under section 108(i), S1 defers recognition of the entire $30 of COD income. In 2010, P sells all the stock of S1 to X, an unrelated corporation, for $300, and P and X make a timely section 338(h)(10) election with respect to the sale. Under paragraph (b)(2)(ii)(A) of this section, an electing corporation takes into account its remaining deferred COD income when it ceases its existence for Federal income tax purposes unless the exception in paragraph (b)(2)(ii)(B) of this section applies. Pursuant to section 338(h)(10) and the regulations, S1 is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the discharge of its liabilities. This deemed value-for-value exchange is not an impairment transaction. Following the deemed sale, while S1 is still a member of the P group, S1 is treated as distributing all of its assets to P and as ceasing its existence. Under these facts, the distribution of all of S1's assets constitutes a deemed liquidation, and is a transaction to which sections 332 and 381(a) apply. Although S1 ceases its corporate existence as a result of the liquidation, S1 is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. P succeeds to S1's remaining deferred COD income and to S1's reporting requirements as if P were the electing corporation. Under paragraph (b)(2)(iii)(F)(*1*) of this section, the intercompany distribution from S1 to P is not an impairment transaction.

(d) *Earnings and profits*—(1) *In general*. Deferred COD income increases earnings and profits in the taxable year that it is realized and not in the taxable year or years that the deferred COD income is includible in gross income. Deferred OID deductions decrease earnings and profits in the taxable year or years in which the deduction would be allowed without regard to section 108(i).

(2) *Exceptions*—(i) *RICs and REITs*. Notwithstanding paragraph (d)(1) of this section, deferred COD income increases earnings and profits of a RIC or REIT in the taxable year or years in which the deferred COD income is includible in gross income and not in the year that the deferred COD income is realized. Deferred OID deductions decrease earnings and profits of a RIC or REIT in the taxable year or years that the deferred OID deductions are deductible.

(ii) *Alternative minimum tax*. For purposes of calculating alternative minimum taxable income, any items of deferred COD income or deferred OID deduction increase or decrease, respectively, adjusted current earnings under section 56(g)(4) in the taxable year or years that the item is includible or deductible.

(e) *Effective/applicability dates*. For *effective/applicability dates, see* § 1.108(i)–0T(b).

(f) *Expiration date*. This section expires August 9, 2013.

■ **Par. 4.** Section 1.108(i)–3T is added to read as follows:

§ 1.108(i)–3T Rules for the deduction of OID (temporary).

(a) *Deemed debt-for-debt exchanges*—(1) *In general.* For purposes of section 108(i)(2) (relating to deferred OID deductions that arise in certain debt-for-debt exchanges involving the reacquisition of an applicable debt instrument), if the proceeds of any debt instrument are used directly or indirectly by the issuer or a person related to the issuer (within the meaning of section 108(i)(5)(A)) to reacquire an applicable debt instrument, the debt instrument shall be treated as issued for the applicable debt instrument being reacquired. Therefore, section 108(i)(2) may apply, for example, to a debt instrument issued by a corporation for cash in which some or all of the proceeds are used directly or indirectly by the corporation's related subsidiary in the reacquisition of the subsidiary's applicable debt instrument.

(2) *Directly or indirectly.* Whether the proceeds of an issuance of a debt instrument are used directly or indirectly to reacquire an applicable debt instrument depends upon all of the facts and circumstances surrounding the issuance and the reacquisition. The proceeds of an issuance of a debt instrument will be treated as being used indirectly to reacquire an applicable debt instrument if—

(i) At the time of the issuance of the debt instrument, the issuer of the debt instrument anticipated that an applicable debt instrument of the issuer or a person related to the issuer would be reacquired by the issuer, and the debt instrument would not have been issued if the issuer had not so anticipated such reacquisition;

(ii) At the time of the issuance of the debt instrument, the issuer of the debt instrument or a person related to the issuer anticipated that an applicable debt instrument would be reacquired by a related person and the related person receives cash or property that it would not have received unless the reacquisition had been so anticipated; or

(iii) At the time of the reacquisition, the issuer or a person related to the issuer foresaw or reasonably should have foreseen that the issuer or a person related to the issuer would be required to issue a debt instrument, which it would not have otherwise been required to issue if the reacquisition had not occurred, in order to meet its future economic needs.

(b) *Proportional rule for accruals of OID.* For purposes of section 108(i)(2), if only a portion of the proceeds from the issuance of a debt instrument are used directly or indirectly to reacquire an applicable debt instrument, the rules of section 108(i)(2)(A) will apply to the portion of OID on the debt instrument that is equal to the portion of the proceeds from such instrument used to reacquire the outstanding applicable debt instrument. Except as provided in the last sentence of section 108(i)(2)(A), the amount of deferred OID deduction that is subject to section 108(i)(2)(A) for a taxable year is equal to the product of the amount of OID that accrues in the taxable year under section 1272 or section 1275 (and the regulations under those sections), whichever section is applicable, and a fraction, the numerator of which is the portion of the total proceeds from the issuance of the debt instrument used directly or indirectly to reacquire the applicable debt instrument and the denominator of which is the total proceeds from the issuance of the debt instrument.

(c) *No acceleration*—(1) *Retirement.* Retirement of a debt instrument subject to section 108(i)(2) does not accelerate deferred OID deductions.

(2) *Cross-reference. See* § 1.108(i)–1T and § 1.108(i)–2T for rules relating to the acceleration of deferred OID deductions.

(d) *Examples.* The application of this section is illustrated by the following examples. Unless otherwise stated, all taxpayers in the following examples are calendar-year taxpayers, and P and S each file separate returns:

Example 1. (i) *Facts.* P, a domestic corporation, owns all of the stock of S, a domestic corporation. S has a debt instrument outstanding that has an adjusted issue price of $100,000. On January 1, 2010, P issues for $160,000 a four-year debt instrument that has an issue price of $160,000 and a stated redemption price at maturity of $200,000, resulting in $40,000 of OID. In P's discussion with potential lenders/holders, and as described in offering materials provided to potential lenders/holders, P disclosed that it planned to use all or a portion of the proceeds from the issuance of the debt instrument to reacquire outstanding debt of P and its affiliates. Following the issuance, P makes a $70,000 capital contribution to S. S then reacquires its debt instrument from X, a person not related to S within the meaning of section 108(i)(5)(A), for $70,000. At the time of the reacquisition, the adjusted issue price of S's debt instrument is $100,000. Under § 1.61–12(c), S realizes $30,000 of COD income. S makes a section 108(i) election for the $30,000 of COD income.

(ii) *Analysis.* Under the facts, at the time of P's issuance of its $160,000 debt instrument, P anticipated that the loan proceeds would be used to reacquire the debt of S, and P's debt instrument would not have been issued for an amount greater than $90,000 if P had not anticipated that S would use the proceeds to reacquire its debt. Pursuant to paragraph (a) of this section, the proceeds from P's issuance of its debt instrument are treated as being used indirectly to reacquire S's applicable debt instrument. Therefore, section 108(i)(2)(B) applies to P's debt instrument and P's OID deductions on its debt instrument are subject to deferral under section 108(i)(2)(A). However, because only a portion of the proceeds from P's debt instrument are used by S to reacquire its applicable debt instrument, only a portion of P's total OID deductions will be deferred under section 108(i)(2)(A). *See* section 108(i)(2)(B). Accordingly, a maximum of $17,500 ($40,000 × $70,000/$160,000) of P's $40,000 total OID deductions is subject to deferral under section 108(i)(2)(A). Under paragraph (b) of this section, the amount of P's deferred OID deduction each taxable year under section 108(i)(2)(A) is equal to the product of the amount of OID that accrues in the taxable year under section 1272 for the debt instrument and a fraction ($70,000/$160,000). As a result, P's deferred OID deductions are the following amounts: $4,015.99 for 2010 ($ 9,179.40 × $70,000/$160,000); $4,246.39 for 2011 ($9,706.04 × $70,000/$160,000); $4,490.01 for 2012 ($10,262.88 × $70,000/$160,000); and $4,747.61 for 2013 ($10,851.68 × $70,000/$160,000).

Example 2. (i) *Facts.* The facts are the same as in *Example 1,* except that S makes a section 108(i) election for only $10,000 of the $30,000 of COD income.

(ii) *Analysis.* The maximum amount of P's deferred OID deductions under section 108(i)(2)(A) is $10,000 rather than $17,500 because S made a section 108(i) election for only $10,000 of the $30,000 of COD income. Under section 108(i)(2)(A), because the amount of OID that accrues prior to 2014 attributable to the portion of the debt instrument issued to indirectly reacquire S's applicable debt instrument under paragraph (b) of this section ($17,500) exceeds the amount of deferred COD income under section 108(i) ($10,000), P's deferred OID deductions are the following amounts: $4,015.99 for 2010; $4,246.39 for 2011; $1,737.62 for 2012; and $0 for 2013.

Example 3. (i) *Facts.* The facts are the same as in *Example 1,* except that P pays $200,000 in cash to the lenders/holders on December 31, 2012, to retire the debt instrument. P did not directly or indirectly obtain the funds to retire the debt instrument from the issuance of another debt instrument with OID.

(ii) *Analysis.* Under paragraph (c)(1) of this section, the retirement of P's debt instrument is not an acceleration event for the deferred OID deductions of $4,015.99 for 2010, $4,246.39 for 2011, and $4,490.01 for 2012. Except as provided in § 1.108(i)–1T(b)(4), these amounts will be taken into account during the inclusion period. P, however, paid a repurchase premium of $10,851.68 in 2012 ($200,000 minus the adjusted issue price of $189,148.32) to retire the debt instrument. If otherwise allowable, P may deduct this amount in 2012 under § 1.163–7(c).

(e) *Effective/applicability dates.* For *effective/applicability dates, see* § 1.108(i)–0T(b).

(f) *Expiration date.* This section expires August 9, 2013.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 5.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 6.** In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * *	* *
1.108(i)–1T	1545–2147
* * *	* *

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Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: August 6, 2010.

Michael Mundaca,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2010–20060 Filed 8–11–10; 11:15 am]

BILLING CODE 4830–01–P

PENSION BENEFIT GUARANTY CORPORATION

29 CFR Part 4022

Benefits Payable in Terminated Single-Employer Plans; Interest Assumptions for Valuing and Paying Benefits

AGENCY: Pension Benefit Guaranty Corporation.

ACTION: Final rule.

SUMMARY: Pension Benefit Guaranty Corporation's regulation on Benefits Payable in Terminated Single-Employer Plans prescribes interest assumptions for valuing and paying certain benefits under terminating single-employer plans. This final rule amends the benefit payments regulation to adopt interest assumptions for plans with valuation dates in September 2010. Interest assumptions are also published on PBGC's Web site (*http://www.pbgc.gov*).

DATES: Effective September 1, 2010.

FOR FURTHER INFORMATION CONTACT: Catherine B. Klion, Manager, Regulatory and Policy Division, Legislative and Regulatory Department, Pension Benefit Guaranty Corporation, 1200 K Street, NW., Washington, DC 20005, 202–326–4024. (TTY/TDD users may call the Federal relay service toll-free at 1–800–877–8339 and ask to be connected to 202–326–4024.)

SUPPLEMENTARY INFORMATION: PBGC's regulations prescribe actuarial assumptions—including interest assumptions—for valuing and paying plan benefits of terminating single-employer plans covered by title IV of the Employee Retirement Income Security Act of 1974. The interest assumptions are intended to reflect current conditions in the financial and annuity markets.

These interest assumptions are found in two PBGC regulations: The regulation on Benefits Payable in Terminated Single-Employer Plans (29 CFR part 4022) and the regulation on Allocation of Assets in Single-Employer Plans (29 CFR part 4044). Assumptions under the asset allocation regulation are updated quarterly; assumptions under the benefit payments regulation are updated monthly. This final rule updates only the assumptions under the benefit payments regulation.

Two sets of interest assumptions are prescribed under the benefit payments regulation: (1) A set for PBGC to use to determine whether a benefit is payable as a lump sum and to determine lump-sum amounts to be paid by PBGC (found in Appendix B to Part 4022), and (2) a set for private-sector pension practitioners to refer to if they wish to use lump-sum interest rates determined using PBGC's historical methodology (found in Appendix C to Part 4022).

This amendment (1) adds to Appendix B to Part 4022 the interest assumptions for PBGC to use for its own lump-sum payments in plans with valuation dates during September 2010, and (2) adds to Appendix C to Part 4022 the interest assumptions for private-sector pension practitioners to refer to if they wish to use lump-sum interest rates determined using PBGC's historical methodology for valuation dates during September 2010.

The interest assumptions that PBGC will use for its own lump-sum payments (set forth in Appendix B to Part 4022) will be 2.25 percent for the period during which a benefit is in pay status and 4.00 percent during any years preceding the benefit's placement in pay status. In comparison with the interest assumptions in effect for August 2010, these interest assumptions are unchanged. For private-sector payments, the interest assumptions (set forth in Appendix C to part 4022) will be the same as those used by PBGC for determining and paying lump sums (set forth in Appendix B to Part 4022).