(13) 1-pentyl-3-[(4-methoxy)-benzoyl]indole (SR–19 and RCS–4)	7104
(14) 1-cyclohexylethyl-3-(2-methoxyphenylacetyl)indole 7008 (SR–18 and RCS–8)	7008
(15) 1-pentyl-3-(2-chlorophenylacetyl)indole (JWH–203)	7203

(h) * * *

(1) 3,4-methylenedioxy-N-methylcathinone (Other names: methylone)	7540

* * * * *

Dated: December 21, 2012.

Michele M. Leonhart,

Administrator.

[FR Doc. 2012–31698 Filed 1–3–13; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9609]

RIN 1545–BK45; 1545–BL29

Treasury Inflation-Protected Securities Issued at a Premium; Bond Premium Carryforward

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations that provide guidance on the tax treatment of Treasury Inflation-Protected Securities issued with more than a de minimis amount of premium. This document also contains temporary regulations that provide guidance on the tax treatment of a debt instrument with a bond premium carryforward in the holder's final accrual period, including a Treasury bill acquired at a premium. The regulations in this document provide guidance to holders of Treasury Inflation-Protected Securities and other debt instruments. The text of the temporary regulations in this document also serves as the text of the proposed regulations (REG–140437–12) set forth in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective on January 4, 2013.

Applicability Dates: For the dates of applicability, see §§ 1.171–2T(a)(4)(i)(C)(*2*) and 1.1275–7(h)(2).

FOR FURTHER INFORMATION CONTACT: William E. Blanchard, (202) 622–3900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 5, 2011, temporary regulations (TD 9561) relating to the federal income tax treatment of Treasury Inflation-Protected Securities issued with more than a de minimis amount of premium were published in the **Federal Register** (76 FR 75781). *See* § 1.1275–7T. A notice of proposed rulemaking (REG–130777–11) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (76 FR 75829). No comments were received on the notice of proposed rulemaking. No public hearing was requested or held.

The proposed regulations are adopted without substantive change by this Treasury decision, and the corresponding temporary regulations are removed.

Explanation of Provisions

1. Final Regulations—Treasury Inflation-Protected Securities (TIPS) Issued With More Than a De Minimis Amount of Premium

The following is a general explanation of the provisions in the final regulations, which are the same as the provisions in the temporary regulations. However, the provisions that were in the temporary regulations are now contained in newly designated paragraphs (g)(2) and (h)(2) of § 1.1275–7 of the final regulations.

TIPS are securities issued by the Department of the Treasury. The principal amount of a TIPS is adjusted for any inflation or deflation that occurs over the term of the security. The rules for the taxation of inflation-indexed debt instruments, including TIPS, are contained in § 1.1275–7 of the Income Tax Regulations. *See also* § 1.171–3(b) (rules for inflation-indexed debt instruments with bond premium).

Under § 1.1275–7(d)(2)(i), the coupon bond method described in § 1.1275–7(d) is not available with respect to inflation-indexed debt instruments that are issued with more than a de minimis amount of premium (that is, an amount greater than .0025 times the stated principal amount of the security times the number of complete years to the security's maturity). Prior to 2011, TIPS had not been issued with more than a de minimis amount of premium, and the coupon bond method had applied to TIPS rather than the more complex discount bond method described in § 1.1275–7(e).

In 2011, the Treasury Department anticipated that TIPS might be issued with more than a de minimis amount of premium. As a result, in Notice 2011–21 (2011–19 IRB 761), to provide a more uniform method for the federal income taxation of TIPS, the Treasury Department and the IRS announced that regulations would be issued to provide that taxpayers must use the coupon bond method described in § 1.1275–7(d) for TIPS issued with more than a de minimis amount of premium. As a result, the discount bond method described in § 1.1275–7(e) would not apply to TIPS issued with more than a de minimis amount of premium. Notice 2011–21 provided that the regulations would be effective for TIPS issued on or after April 8, 2011. On December 5, 2011, the Treasury Department and the IRS published the temporary regulations in the **Federal Register**. These temporary regulations contained the rules described in Notice 2011–21 and applied to TIPS issued on or after April 8, 2011. As noted earlier in this preamble, the final regulations are substantively the same as the temporary regulations.

Under the final regulations, a taxpayer must use the coupon bond method described in § 1.1275–7(d) for a TIPS that is issued with more than a de minimis amount of premium. The final regulations include the example from the temporary regulations illustrating how to apply the coupon bond method to a TIPS issued with more than a de minimis amount of premium and a negative yield. As stated in Notice 2011–21, the final regulations apply to TIPS issued on or after April 8, 2011. *See* § 601.601(d)(2)(ii)(b).

2. Temporary Regulations—Treatment of Bond Premium Carryforward in a Holder's Final Accrual Period

During the consideration of the final regulations relating to TIPS issued with more than a de minimis amount of premium, the Treasury Department and the IRS received questions about the holder's treatment of a taxable zero coupon debt instrument, including a Treasury bill, acquired at a premium and a negative yield. In this situation, as described in more detail below, under §§ 1.171–2 and 1.1016–5(b) of the current regulations, a holder that elected to amortize the bond premium generally would have a capital loss upon the sale, retirement, or other disposition of the debt instrument rather than an ordinary deduction under section 171(a)(1) for all or a portion of the bond premium. This situation, which has arisen as a result of recent market conditions, was not contemplated when the current regulations were adopted in 1997.

Under section 171 and § 1.171–2 of the current regulations, an electing holder amortizes bond premium by offsetting the qualified stated interest (as defined in § 1.1273–1(c)) allocable to an accrual period with the bond premium allocable to the period. If the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period, the excess is treated by the holder as a bond premium deduction under section 171(a)(1) for the accrual period. However, the amount treated as a bond premium deduction is limited to the amount by which the holder's total interest inclusions on the bond in prior accrual periods exceed the total amount treated by the holder as a bond premium deduction on the bond in prior accrual periods. If the bond premium allocable to an accrual period exceeds the sum of the qualified stated interest allocable to the accrual period and the amount treated as a deduction under section 171(a)(1), the excess is carried forward to the next accrual period and is treated as bond premium allocable to that period. *See* § 1.171–2(a)(4). Under § 1.1016–5(b) of the current regulations, a holder's basis in a bond is reduced by the amount of bond premium used to offset qualified stated interest on the bond and the amount of bond premium allowed as a deduction under section 171(a)(1).

In the case of a zero coupon debt instrument, including a Treasury bill, there is no qualified stated interest. Therefore, under § 1.171–2, the amount of bond premium allocable to an accrual period will always exceed the qualified stated interest allocable to the accrual period (zero) and, because there will be no bond premium deductions in any prior accrual periods, such amount will be carried forward to the next accrual period. As a result, upon the sale, retirement, or other disposition of the debt instrument, there will be a bond premium carryforward determined as of the end of the holder's final accrual period in an amount equal to the total amount of bond premium allocable to the holder's final accrual period, which includes the bond premium allocable by the holder to each prior accrual period. In this situation, because there is no qualified stated interest to offset the bond premium carryforward and because the holder's basis in the bond has not been reduced, under the current regulations, the holder would have a capital loss in an amount at least equal to the bond premium carryforward. The Treasury Department and the IRS, however, believe that the amount of the bond premium carryforward in this situation should be treated as a bond premium deduction under section 171(a)(1) rather than as a capital loss for the holder's taxable year in which the sale, retirement, or other disposition occurs.

In order to provide immediate guidance to investors, the temporary regulations in this document and the notice of proposed rulemaking that cross-references these temporary regulations (REG–140437–12) address this issue by adding a specific rule for the treatment of a bond premium carryforward determined as of the end of the holder's final accrual period for any taxable bond for which the holder has elected to amortize bond premium. Thus, for example, under § 1.171–2T(a)(4)(i)(C), an electing holder that purchases a taxable zero coupon debt instrument at a premium deducts all or a portion of the premium under section 171(a)(1) when the instrument is sold, retired, or otherwise disposed of rather than as a capital loss.

In addition, because the rules in § 1.171–3 for inflation-indexed debt instruments, including TIPS, generally treat a bond premium carryforward as a deflation adjustment, § 1.171–3 is amended to apply the rule in § 1.171–2T(a)(4)(i)(C)(*1*) to any remaining deflation adjustment attributable to bond premium as of the end of the holder's accrual period in which the bond is sold, retired, or otherwise disposed of.

Section 1.171–2T(a)(4)(i)(C)(*1*) applies to a debt instrument (bond) acquired on or after January 4, 2013. A taxpayer, however, may rely on this section for a debt instrument (bond) acquired before that date.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received. In addition, pursuant to section 7805(f) of the Code, the temporary regulations in this document have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William E. Blanchard, Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by removing the entry for § 1.1275–7T and by adding an entry in numerical order to read in part as follows:

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

Section 1.171–2T also issued under 26 U.S.C. 171(e). * * *

■ **Par. 2.** Section 1.171–2T is added to read as follows:

§ 1.171–2T Amortization of bond premium (temporary).

(a)(1) through (a)(4)(i)(B) [Reserved]. For further guidance, see § 1.171–2(a)(1) through (a)(4)(i)(B).

(C) *Carryforward in holder's final accrual period*—(*1*) If there is a bond premium carryforward determined under § 1.171–2(a)(4)(i)(B) as of the end of the holder's accrual period in which the bond is sold, retired, or otherwise disposed of, the holder treats the amount of the carryforward as a bond premium deduction under section 171(a)(1) for the holder's taxable year in which the sale, retirement, or other disposition occurs. For purposes of § 1.1016–5(b), the holder's basis in the bond is reduced by the amount of bond premium allowed as a deduction under this paragraph (a)(4)(i)(C)(*1*).

(*2*) *Effective/applicability date.* Notwithstanding § 1.171–5(a)(1), paragraph (a)(4)(i)(C)(*1*) of this section applies to a bond acquired on or after January 4, 2013. A taxpayer, however, may rely on paragraph (a)(4)(i)(C)(*1*) of this section for a bond acquired before that date.

(ii) through (c) [Reserved]. For further guidance, see § 1.171–2(a)(4)(ii) through (c).

(d) *Expiration date.* The applicability of this section expires on or before December 31, 2015.

■ **Par. 3.** Section 1.171–3 is amended by adding a new sentence before the last sentence in paragraph (b) to read as follows:

§ 1.171–3 Special rules for certain bonds.

* * * * *

(b) * * * However, the rules in § 1.171–2T(a)(4)(i)(C) apply to any remaining deflation adjustment attributable to bond premium as of the end of the holder's accrual period in which the bond is sold, retired, or otherwise disposed of. * * *

* * * * *

■ **Par. 4.** Section 1.1271–0(b) is amended by revising the entries for § 1.1275–7(g) and (h) to read as follows:

§ 1.1271–0 Original issue discount; effective date; table of contents.

* * * * *

(b) * * *

* * * * *

§ 1.1275–7 Inflation-indexed debt instruments.

* * * * *

(g) TIPS.

(1) Reopenings.

(2) TIPS issued with more than a de minimis amount of premium.

(h) Effective/applicability dates.

(1) In general.

(2) TIPS issued with more than a de minimis amount of premium.

■ **Par. 5.** Section 1.1275–7 is amended as follows:

■ 1. Revising the last sentence of paragraph (b)(1).

■ 2. Adding a new sentence at the end of paragraph (d)(2)(i).

■ 3. Revising paragraph (g).

■ 4. Revising paragraph (h).

The revisions and addition read as follows:

§ 1.1275–7 Inflation-indexed debt instruments.

* * * * *

(b) * * *

(1) * * * For example, this section applies to Treasury Inflation-Protected Securities (TIPS).

* * * * *

(d) * * *

(2) * * *

(i) * * * See paragraph (g)(2) of this section, however, for the treatment of TIPS issued with more than a de minimis amount of premium.

* * * * *

(g) *TIPS*—(1) *Reopenings.* For rules concerning a reopening of TIPS, see paragraphs (d)(2), (k)(3)(iii), and (k)(3)(v) of § 1.1275–2.

(2) *TIPS issued with more than a de minimis amount of premium*—(i) *Coupon bond method.* Notwithstanding paragraph (d)(2)(i) of this section, the coupon bond method described in paragraph (d) of this section applies to TIPS issued with more than a de minimis amount of premium. For this purpose, the de minimis amount is determined using the principles of § 1.1273–1(d).

(ii) *Example.* The following example illustrates the application of the bond premium rules to a TIPS issued with bond premium:

Example. (i) *Facts.* X, a calendar year taxpayer, purchases at original issuance TIPS with a stated principal amount of $100,000 and a stated interest rate of .125 percent, compounded semiannually. For purposes of this example, assume that the TIPS are issued in Year 1 on January 1, stated interest is payable on June 30 and December 31 of each year, and that the TIPS mature on December 31, Year 5. X pays $102,000 for the TIPS, which is the issue price for the TIPS as determined under § 1.1275–2(d)(1). Assume that the inflation-adjusted principal amount for the first coupon in Year 1 is $101,225 (resulting in an interest payment of $63.27) and for the second coupon in Year 1 is $102,500 (resulting in an interest payment of $64.06). X elects to amortize bond premium under § 1.171–4. (For simplicity, contrary to actual practice, the TIPS in this example were issued on the date with respect to which the calculation of the first coupon began.)

(ii) *Bond premium.* The stated interest on the TIPS is qualified stated interest under § 1.1273–1(c). X acquired the TIPS with bond premium of $2,000 (basis of $102,000 minus the TIPS' stated principal amount of $100,000). *See* §§ 1.171–1(d), 1.171–3(b), and paragraph (f)(3) of this section. The $2,000 is more than the de minimis amount of premium for the TIPS of $1,250 (.0025 times the stated principal amount of the TIPS ($100,000) times the number of complete years to the TIPS' maturity (5 years)). Under paragraph (g)(2)(i) of this section, X must use the coupon bond method to determine X's income from the TIPS.

(iii) *Allocation of bond premium.* Under § 1.171–3(b), the bond premium of $2,000 is allocable to each semiannual accrual period by assuming that there will be no inflation or deflation over the term of the TIPS. Moreover, for purposes of § 1.171–2, the yield of the securities is determined by assuming that there will be no inflation or deflation over their term. Based on this assumption, for purposes of section 171, the TIPS provide for semiannual interest payments of $62.50 and a $100,000 payment at maturity. As a result, the yield of the securities for purposes of section 171 is −0.2720 percent, compounded semiannually. Under § 1.171–2, the bond premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period ($62.50 for each accrual period) over the product of the taxpayer's adjusted acquisition price at the beginning of the accrual period (determined without regard to any inflation or deflation) and the taxpayer's yield. Therefore, the $2,000 of bond premium is allocable to each semiannual accrual period in Year 1 as follows: $201.22 to the accrual period ending on June 30, Year 1 (the excess of the stated interest of $62.50 over ($102,000 × −0.002720/2)); and $200.95 to the accrual period ending on December 31, Year 1 (the excess of the stated interest of $62.50 over ($101,798.78 × −0. 002720/2)). The adjusted acquisition price at the beginning of the accrual period ending on December 31, Year 1 is $101,798.78 (the adjusted acquisition price of $102,000 at the beginning of the accrual period ending on June 30, Year 1 reduced by the $201.22 of premium allocable to that accrual period).

(iv) *Income determined by applying the coupon bond method and the bond premium rules.* Under paragraph (d)(4) of this section, the application of the coupon bond method to the TIPS results in a positive inflation adjustment in Year 1 of $2,500, which is includible in X's income for Year 1. However, because X acquired the TIPS at a premium and elected to amortize the premium, the premium allocable to Year 1 will offset the income on the TIPS as follows: The premium allocable to the first accrual period of $201.22 first offsets the interest payable for that period of $63.27. The remaining $137.95 of premium is treated as a deflation adjustment that offsets the positive inflation adjustment. *See* § 1.171–3(b). The premium allocable to the second accrual period of $200.95 first offsets the interest payable for that period of $64.06. The remaining $136.89 of premium is treated as a deflation adjustment that further offsets the positive inflation adjustment. As a result, X does not include in income any of the stated interest received in Year 1 and includes in Year 1 income only $2,225.16 of the positive inflation adjustment for Year 1 ($2,500 − $137.94 − $136.89).

(h) *Effective/applicability dates*—(1) *In general.* This section applies to an inflation-indexed debt instrument issued on or after January 6, 1997.

(2) *TIPS issued with more than a de minimis amount of premium.* Notwithstanding paragraph (h)(1) of this section, paragraph (g)(2) of this section applies to TIPS issued with more than a de minimis amount of premium on or after April 8, 2011.

§ 1.1275–7T [Removed]

■ **Par. 6.** Section 1.1275–7T is removed.

■ **Par. 7.** Section 1.1286–2 is amended by removing the language "Inflation-Indexed" and adding the language "Inflation-Protected" in its place.

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: December 20, 2012.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2012–31747 Filed 1–3–13; 8:45 am]

BILLING CODE 4830–01–P