

ing in the spread period (not including the current year).

The excess described in subparagraph (B)(ii)(II)(a) shall be reduced by any amount taken into account under this subclause or clause (i)(II) in any prior year.

“(C) SPREAD PERIOD.—For purposes of this paragraph, the term ‘spread period’ means the period consisting of the 5 taxable years beginning with the year for which the election is made under paragraph (1).

“(D) CASH BASIS INCOME.—For purposes of this paragraph, the term ‘cash basis income’ means for any taxable year the aggregate amount which would be includible in the gross income of the taxpayer with respect to short-term obligations described in subsection (b) of section 1281 of such Code if the provisions of section 1281 of such Code did not apply to such taxable year and all prior taxable years within the spread period.

“(E) ACCRUAL BASIS INCOME.—For purposes of this paragraph, the term ‘accrual basis income’ means for any taxable year the aggregate amount includible in gross income under section 1281(a) of such Code for such a taxable year and all prior taxable years within the spread period.

“(f) TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.—Section 1288 of such Code (as added by section 41) shall apply to obligations issued after September 3, 1982, and acquired after March 1, 1984.

“(g) REPEAL OF CAPITAL ASSET REQUIREMENT.—Section 1272 of such Code (as added by section 41) shall not apply to any obligation issued on or before December 31, 1984, which is not a capital asset in the hands of the taxpayer.

“(h) REPORTING REQUIREMENTS.—Section 1275(c) of such Code (as added by section 41) and the amendments made by section 41(c) [enacting section 6706 of this title] shall take effect on the day 30 days after the date of the enactment of this Act [July 18, 1984].

“(i) OTHER MISCELLANEOUS CHANGES.—

“(1) ACCRUAL PERIOD.—In the case of any obligation issued after July 1, 1982, and before January 1, 1985, the accrual period, for purposes of section 1272(a) of the Internal Revenue Code of 1986 (as amended by section 41(a)), shall be a 1-year period (or shorter period to maturity) beginning on the day in the calendar year which corresponds to the date of original issue of the obligation.

“(2) CHANGE IN REDUCTION FOR PURCHASE AFTER ORIGINAL ISSUE.—Section 1272(a)(6) of such Code (as so amended) shall not apply to any purchase on or before the date of the enactment of this Act [July 18, 1984], and the rules of section 1232A(a)(6) of such Code (as in effect on the day before the date of the enactment of this Act) shall continue to apply to such purchase.

“(j) CLARIFICATION THAT PRIOR EFFECTIVE DATE RULES NOT AFFECTED.—Nothing in the amendment made by section 41(a) shall affect the application of any effective date provision (including any transitional rule) for any provision which was a predecessor to any provision contained in part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (as added by section 41).”

[Amendment of section 44 of Pub. L. 98-369, set out above, by Pub. L. 98-612 (which added pars. (4) to (7) to subsec. (b)) not applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.]

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L.

99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1272. Current inclusion in income of original issue discount

(a) Original issue discount included in income on basis of constant interest rate

(1) General rule

For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

(2) Exceptions

Paragraph (1) shall not apply to—

(A) Tax-exempt obligations

Any tax-exempt obligation.

(B) United States savings bonds

Any United States savings bond.

(C) Short-term obligations

Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

(D) Loans between natural persons

(i) In general

Any loan made by a natural person to another natural person if—

(I) such loan is not made in the course of a trade or business of the lender, and

(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed \$10,000.

(ii) Clause (i) not to apply where tax avoidance a principal purpose

Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

(iii) Treatment of husband and wife

For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

(3) Determination of daily portions

For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

(A) the product of—

(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

(4) Adjusted issue price

For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

(A) the issue price of such debt instrument, plus

(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

(5) Accrual period

Except as otherwise provided in regulations prescribed by the Secretary, the term “accrual period” means a 6-month period (or shorter period from the date of original issue of the debt instrument) which ends on a day in the calendar year corresponding to the maturity date of the debt instrument or the date 6 months before such maturity date.

(6) Determination of daily portions where principal subject to acceleration

(A) In general

In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of—

(i) the sum of (I) the present value determined under subparagraph (B) of all remaining payments under the debt instrument as of the close of such period, and (II) the payments during the accrual period of amounts included in the stated redemption price of the debt instrument, over

(ii) the adjusted issue price of such debt instrument at the beginning of such period.

(B) Determination of present value

For purposes of subparagraph (A), the present value shall be determined on the basis of—

(i) the original yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period),

(ii) events which have occurred before the close of the accrual period, and

(iii) a prepayment assumption determined in the manner prescribed by regulations.

(C) Debt instruments to which paragraph applies

This paragraph applies to—

(i) any regular interest in a REMIC or qualified mortgage held by a REMIC,

(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt in-

strument (or, to the extent provided in regulations, by reason of other events), or

(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.

(7) Reduction where subsequent holder pays acquisition premium

(A) Reduction

For purposes of this subsection, in the case of any purchase after its original issue of a debt instrument to which this subsection applies, the daily portion for any day shall be reduced by an amount equal to the amount which would be the daily portion for such day (without regard to this paragraph) multiplied by the fraction determined under subparagraph (B).

(B) Determination of fraction

For purposes of subparagraph (A), the fraction determined under this subparagraph is a fraction—

(i) the numerator of which is the excess (if any) of—

(I) the cost of such debt instrument incurred by the purchaser, over

(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph), and

(ii) the denominator of which is the sum of the daily portions for such debt instrument for all days after the date of such purchase and ending on the stated maturity date (computed without regard to this paragraph).

(b) Exceptions

This section shall not apply to any holder—

(1) who has purchased the debt instrument at a premium, or

(2) which is a life insurance company to which section 811(b) applies.

(c) Definition and special rule

(1) Purchase defined

For purposes of this section, the term “purchase” means—

(A) any acquisition of a debt instrument, where

(B) the basis of the debt instrument is not determined in whole or in part by reference to the adjusted basis of such debt instrument in the hands of the person from whom acquired.

(2) Basis adjustment

The basis of any debt instrument in the hands of the holder thereof shall be increased

by the amount included in his gross income pursuant to this section.

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 533; amended Pub. L. 99-514, title VI, § 672, Oct. 22, 1986, 100 Stat. 2318; Pub. L. 105-34, title X, § 1004(a), Aug. 5, 1997, 111 Stat. 911; Pub. L. 115-141, div. U, title IV, § 401(c)(1)(B), (F), (3)(A), Mar. 23, 2018, 132 Stat. 1205, 1206.)

Editorial Notes

AMENDMENTS

2018—Subsec. (a). Pub. L. 115-141, § 401(c)(1)(F)(i), struck out “on debt instruments issued after July 1, 1982,” after “discount” in heading.

Subsec. (a)(1). Pub. L. 115-141, § 401(c)(1)(F)(ii), struck out “issued after July 1, 1982” before “, an amount equal to”.

Subsec. (a)(2)(D), (E). Pub. L. 115-141, § 401(c)(3)(A), redesignated subpar. (E) as (D) and struck out former subpar. (D). Prior to amendment, text of subpar. (D) read as follows: “Any obligation issued by a natural person before March 2, 1984.”

Subsecs. (b) to (d). Pub. L. 115-141, § 401(c)(1)(B), redesignated subsecs. (c) and (d) as (b) and (c), respectively, and struck out former subsec. (b) which related to ratable inclusion retained for corporate debt instruments issued before July 2, 1982.

1997—Subsec. (a)(6)(C). Pub. L. 105-34 added cl. (iii) and concluding provisions.

1986—Subsec. (a)(6), (7). Pub. L. 99-514 added par. (6) and redesignated former par. (6) as (7).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 2018 AMENDMENT

Amendment by section 401(c)(1)(B), (F) of Pub. L. 115-141 applicable to debt instruments issued on or after July 2, 1982, see section 401(c)(1)(H) of Pub. L. 115-141, set out as a note under section 163 of this title.

Amendment by section 401(c)(3)(A) of Pub. L. 115-141 applicable to obligations issued on or after Mar. 2, 1984, see section 401(c)(3)(C) of Pub. L. 115-141, set out as a note under section 163 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title X, § 1004(b)(1), Aug. 5, 1997, 111 Stat. 911, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to debt instruments issued after Dec. 31, 1986, in taxable years ending after such date, see section 675(b) of Pub. L. 99-514, set out as an Effective Date note under section 860A of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, but not applicable to any obligation issued on or before Dec. 31, 1984, which is not a capital asset in the hands of the taxpayer, and subsec. (a)(6) of this section not applicable to any purchase on or before July 18, 1984, see section 44 of Pub. L. 98-369, as amended, set out as a note under section 1271 of this title.

CHANGE IN METHOD OF ACCOUNTING

Pub. L. 105-34, title X, § 1004(b)(2), Aug. 5, 1997, 111 Stat. 911, provided that: “In the case of any taxpayer required by this section [amending this section and enacting provisions set out as a note above] to change its method of accounting for its first taxable year beginning after the date of the enactment of this Act [Aug. 5, 1997]—

“(A) such change shall be treated as initiated by the taxpayer,

“(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

“(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.”

§ 1273. Determination of amount of original issue discount

(a) General rule

For purposes of this subpart—

(1) In general

The term “original issue discount” means the excess (if any) of—

(A) the stated redemption price at maturity, over

(B) the issue price.

(2) Stated redemption price at maturity

The term “stated redemption price at maturity” means the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time (other than any interest based on a fixed rate, and payable unconditionally at fixed periodic intervals of 1 year or less during the entire term of the debt instrument).

(3) ¼ of 1 percent de minimis rule

If the original issue discount determined under paragraph (1) is less than—

(A) ¼ of 1 percent of the stated redemption price at maturity, multiplied by

(B) the number of complete years to maturity,

then the original issue discount shall be treated as zero.

(b) Issue price

For purposes of this subpart—

(1) Publicly offered debt instruments not issued for property

In the case of any issue of debt instruments—

(A) publicly offered, and

(B) not issued for property,

the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instruments was sold.

(2) Other debt instruments not issued for property

In the case of any issue of debt instruments not issued for property and not publicly offered, the issue price of each such instrument is the price paid by the first buyer of such debt instrument.

(3) Debt instruments issued for property where there is public trading

In the case of a debt instrument which is issued for property and which—

(A) is part of an issue a portion of which is traded on an established securities market, or

(B)(i) is issued for stock or securities which are traded on an established securities market, or