

SUBPART C—DISCOUNT ON SHORT-TERM
OBLIGATIONS

Sec.	
1281.	Current inclusion in income of discount on certain short-term obligations.
1282.	Deferral of interest deduction allocable to accrued discount.
1283.	Definitions and special rules.

§ 1281. Current inclusion in income of discount on certain short-term obligations

(a) General rule

In the case of any short-term obligation to which this section applies, for purposes of this title—

- (1) there shall be included in the gross income of the holder an amount equal to the sum of the daily portions of the acquisition discount for each day during the taxable year on which such holder held such obligation, and
- (2) any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) shall be included in gross income as it accrues.

(b) Short-term obligations to which section applies

(1) In general

This section shall apply to any short-term obligation which—

- (A) is held by a taxpayer using an accrual method of accounting,
- (B) is held primarily for sale to customers in the ordinary course of the taxpayer's trade or business,
- (C) is held by a bank (as defined in section 581),
- (D) is held by a regulated investment company or a common trust fund,
- (E) is identified by the taxpayer under section 1256(e)(2) as being part of a hedging transaction, or
- (F) is a stripped bond or stripped coupon held by the person who stripped the bond or coupon (or by any other person whose basis is determined by reference to the basis in the hands of such person).

(2) Treatment of obligations held by pass-thru entities

(A) In general

This section shall apply also to—

- (i) any short-term obligation which is held by a pass-thru entity which is formed or availed of for purposes of avoiding the provisions of this section, and
- (ii) any short-term obligation which is acquired by a pass-thru entity (not described in clause (i)) during the required accrual period.

(B) Required accrual period

For purposes of subparagraph (A), the term "required accrual period" means the period—

- (i) which begins with the first taxable year for which the ownership test of subparagraph (C) is met with respect to the pass-thru entity (or a predecessor), and
- (ii) which ends with the first taxable year after the taxable year referred to in

clause (i) for which the ownership test of subparagraph (C) is not met and with respect to which the Secretary consents to the termination of the required accrual period.

(C) Ownership test

The ownership test of this subparagraph is met for any taxable year if, on at least 90 days during the taxable year, 20 percent or more of the value of the interests in the pass-thru entity are held by persons described in paragraph (1) or by other pass-thru entities to which subparagraph (A) applies.

(D) Pass-thru entity

The term "pass-thru entity" means any partnership, S corporation, trust, or other pass-thru entity.

(c) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 548; amended Pub. L. 99-514, title XVIII, §1803(a)(7), (8)(A), Oct. 22, 1986, 100 Stat. 2793, 2794.)

Editorial Notes

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514, §1803(a)(8), amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

Subsec. (b)(1)(F). Pub. L. 99-514, §1803(a)(7), added subpar. (F).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1803(a)(7) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Section 1803(a)(8)(A) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1018(c)(1), Nov. 10, 1988, 102 Stat. 3578, provided that the amendment made by section 1803(a)(8)(A) of Pub. L. 99-514 is effective with respect to obligations acquired after Dec. 31, 1985.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations acquired after that date, with certain elections available, see section 44 of Pub. L. 98-369, set out as a note under section 1271 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.

§ 1282. Deferral of interest deduction allocable to accrued discount

(a) General rule

Except as otherwise provided in this section, the net direct interest expense with respect to

any short-term obligation shall be allowed as a deduction for the taxable year only to the extent such expense exceeds the sum of—

(1) the daily portions of the acquisition discount for each day during the taxable year on which the taxpayer held such obligation, and

(2) the amount of any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) which accrues during the taxable year while the taxpayer held such obligation (and is not included in the gross income of the taxpayer for such taxable year by reason of the taxpayer's method of accounting).

(b) Section not to apply to obligations to which section 1281 applies

(1) In general

This section shall not apply to any short-term obligation to which section 1281 applies.

(2) Election to have section 1281 apply to all obligations

(A) In general

A taxpayer may make an election under this paragraph to have section 1281 apply to all short-term obligations acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

(B) Period to which election applies

An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(c) Certain rules made applicable

Rules similar to the rules of subsections (b) and (c) of section 1277 shall apply for purposes of this section.

(d) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 549; amended Pub. L. 99-514, title XVIII, §1803(a)(8)(B), Oct. 22, 1986, 100 Stat. 2794.)

Editorial Notes

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514 amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

Statutory Notes and Related Subsidiaries

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and to obligations acquired after that date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

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§ 1283. Definitions and special rules

(a) Definitions

For purposes of this subpart—

(1) Short-term obligation

(A) In general

Except as provided in subparagraph (B), the term “short-term obligation” means any bond, debenture, note, certificate, or other evidence of indebtedness which has a fixed maturity date not more than 1 year from the date of issue.

(B) Exceptions for tax-exempt obligations

The term “short-term obligation” shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

(2) Acquisition discount

The term “acquisition discount” means the excess of—

(A) the stated redemption price at maturity (as defined in section 1273), over

(B) the taxpayer's basis for the obligation.

(b) Daily portion

For purposes of this subpart—

(1) Ratable accrual

Except as otherwise provided in this subsection, the daily portion of the acquisition discount is an amount equal to—

(A) the amount of such discount, divided by

(B) the number of days after the day on which the taxpayer acquired the obligation and up to (and including) the day of its maturity.

(2) Election of accrual on basis of constant interest rate (in lieu of ratable accrual)

(A) In general

At the election of the taxpayer with respect to any obligation, the daily portion of the acquisition discount for any day is the portion of the acquisition discount accruing on such day determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the taxpayer's yield to maturity based on the taxpayer's cost of acquiring the obligation, and
- (ii) compounding daily.

(B) Election irrevocable

An election under subparagraph (A), once made with respect to any obligation, shall be irrevocable.

(c) Special rules for nongovernmental obligations

(1) In general

In the case of any short-term obligation which is not a short-term Government obligation (as defined in section 1271(a)(3)(B))—