

(ii) *Special rules.* If an obligation is originally issued after September 7, 1990 pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued on or before May 10, 1990, then the issuer may choose to apply either the rules of § 1.163-5(c)(2)(i)(A) or § 1.163-5(c)(2)(i)(B), or the rules of § 1.163-5(c)(2)(i)(D). The issuer of an obligation may choose to apply either the rules of § 1.163-5(c)(2)(i)(A) or (B), or the rules of § 1.163-5(c)(2)(i)(D), to an obligation that is originally issued after May 10, 1990, and on or before September 7, 1990. However, any issuer choosing to apply the rules of § 1.163-5(c)(2)(i)(A) must apply the definition of United States person used for such purposes on December 31, 1989, and must obtain any certificates that would have been required under applicable law on December 31, 1989.

[T.D. 8110, 51 FR 45456, Dec. 19, 1986, as amended by T.D. 8203, 53 FR 17926, May 19, 1988; T.D. 8300, 55 FR 19624, May 10, 1990; T.D. 8734, 62 FR 53416, Oct. 14, 1997]

§ 1.163-5T Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form (temporary).

(a)—(c) [Reserved]

(d) *Pass-through certificates.* (1) A pass-through or participation certificate evidencing an interest in a pool of mortgage loans which under subpart E of subchapter J of the Code is treated as a trust of which the grantor is the owner (or similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust) (“pass-through certificate”) is considered to be a “registration-required obligation” under section 163(f)(2)(A) and § 1.163-5(c) if the pass-through certificate is described in section 163(f)(2)(A) and § 1.163-5(c) without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in section 163(f)(2)(A) and § 1.163-5(c). A pass-through certificate is considered to be described in section 163(f)(2)(B) and § 1.163-5(c) if the pass-through certificate is described in section 163(f)(2)(B) and § 1.163-5(c) without regard to whether any obligation held by the

fund or trust to which the pass-through certificate relates is described in section 163(f)(2)(B) and § 1.163-5(c).

(2) An obligation held by a fund or trust in which ownership interests are represented by pass-through certificates is considered to be in registered form under section 149(a) and the regulations thereunder or to be described in section 163(f)(2)(A) or (B), if the obligation held by the fund or trust is in registered form under section 149(a) and the regulations thereunder or is described in section 163(f)(2)(A) or (B), respectively, without regard to whether the pass-through certificates are so considered.

(3) For purposes of section 4701, a pass-through certificate is considered to be issued solely by the recipient of the proceeds from the issuance of the pass-through certificate (hereinafter the “sponsor”). The sponsor is therefore liable for any excise tax under section 4701 that may be imposed with reference to the principal amount of the pass-through certificate.

(4) In order to implement the purpose of section 163, § 1.163-5(c) and this section, the Commissioner may characterize a certificate or other evidence of interest in a fund or trust which under subpart E of subchapter J of the Code is treated as a trust of which the grantor is the owner and any obligation held by such fund or trust in accordance with the substance of the arrangement they represent and may impose the penalties provided under sections 163(f)(1) and 4701 in the appropriate amounts and on the appropriate persons. This provision may be applied, for example, where a corporation issues obligations purportedly in registered form, contributes them to a grantor trust as its only assets, and arranges for the sale to investors of bearer certificates of interest in the trust which do not meet the requirements of section 163(f)(2)(B). If this provision is applied, the obligations held by the fund or trust will not be considered to be issued in registered form or to meet the requirements of section 163(f)(2)(B). The corporation will not be allowed a deduction for the payment of interest on the obligations held by the trust, and the excise tax under section 4701,

calculated with reference to the principal amount of the obligations held by the trust will be imposed on the corporation may be collected from the corporation and its agents. This paragraph (d)(4) will not be applied so as to alter the tax consequences of transactions as to which rulings have been issued by the Internal Revenue Service prior to September 19, 1985.

(5) The rules set forth in this paragraph (d) apply solely for purposes of sections 4701, 163(f)(2)(A), 163(f)(2)(B), § 1.163-5(c), and any other section that refers to this section for the definition of the term “registration-required obligation” (such as the regulations under sections 871(h) and 881(c)). The treatment of obligations described in this paragraph (d) for purposes of section 163(f)(2) (A) and (B) does not affect the determination of whether bearer obligations that are issued or guaranteed by the United States Government, a United States Government-owned agency, a United States Government sponsored enterprise (within the meaning of § 1.163-5(c)(1)) or that are backed (as described in the Treasury Department News Release R-2835 of September 10, 1984 and Treasury Department News Release R-2847 of September 14, 1984) by obligations issued by the United States Government, a United States Government-owned agency, or a United States Government sponsored enterprise comply with the requirements of section 163(f)(2)(B) and the regulations thereunder.

(6) The provisions of paragraphs (d) (1) through (5) may be illustrated by the following example:

Commercial Bank K forms a pool of 1000 residential mortgage loans, each made to a different individual homeowner, by assigning them to Commercial Bank L, an unrelated entity serving as trustee of the pool. Commercial Bank L immediately sells in a public offering certificates of interest in the trust of a maturity of 10 years in registered form. Commercial Bank L transfers the cash proceeds of the offering to Commercial Bank K. The certificates of interest in the trust are of a type offered to the public and are not described in section 163(f)(2)(B). Pursuant to paragraph (d)(1), the certificates of interest in the pool are registration-required obligations without regard to the fact that the obligations held by the trust are not registration-required obligations.

(e) *Regular interests in REMICS.* (1) A regular interest in a REMIC, as defined in sections 860D and 860G and the regulations thereunder, is considered to be a “registration-required obligation” under section 163(f)(2)(A) and § 1.163-5(c) if the regular interest is described in section 163(f)(2)(A) and § 1.163-5(c), without regard to whether any obligation held by the REMIC to which the regular interest relates is described in section 163(f)(2)(A) and § 1.163-5(c). A regular interest in a REMIC is considered to be described in section 163(f)(2)(B) and § 1.163-5(c), if the regular interest is described in section 163(f)(2)(B) and § 1.163(c), without regard to whether any obligation held by the REMIC to which the regular interest relates is described in section 163(f)(2)(B) and § 1.163-5(c).

(2) An obligation held by a REMIC is considered to be described in section 163(f)(2) (A) or (B) if such obligation is described in section 163(f)(2) (A) or (B), respectively, without regard to whether the regular interests in the REMIC are so considered.

(3) For purposes of section 4701, a regular interest is considered to be issued solely by the recipient of the proceeds from the issuance of the regular interest (hereinafter the “sponsor”). The sponsor is therefore liable for any excise tax under section 4701 that may be imposed with reference to the principal amount of the regular interest.

(4) In order to implement the purpose of section 163, § 1.163-5(c), and this section, the Commissioner may characterize a regular interest in a REMIC and any obligation held by such REMIC in accordance with the substance of the arrangement they represent and may impose the penalties provided under sections 163(f)(1) and 4701 in the appropriate amounts and on the appropriate persons. This provision may be applied, for example, where a corporation issues an obligation that is purportedly in registered form and that will qualify as a “qualified mortgage” within the meaning of section 860G(a)(3) in the hands of a REMIC, contributes the obligation to a REMIC as its only asset, and arranges for the sale to investors of regular interests in the REMIC in bearer form that do not meet the requirements of section 163(f)(2)(B). If

this provision is applied, the obligation held by the REMIC will not be considered to be issued in registered form or to meet the requirements of section 163(f)(2)(B). The corporation will not be allowed a deduction for the payment of interest on the obligation held by the REMIC, and the excise tax under section 4701, calculated with reference to the principal amount of the obligation held by the REMIC, will be imposed on the corporation and may be collected from the corporation and its agents.

[T.D. 8202, 53 FR 17928, May 19, 1988, as amended by T.D. 8300, 55 FR 19626, May 10, 1990]

§ 1.163-6T Reduction of deduction where section 25 credit taken (temporary).

(a) *In general.* The amount of the deduction under section 163 for interest paid or accrued during any taxable year on a certified indebtedness amount with respect to a mortgage credit certificate which has been issued under section 25 shall be reduced by the amount of the credit allowable with respect to such interest under section 25 (determined without regard to section 26).

(b) *Cross reference.* See §§ 1.25-1T through 1.25-8T with respect to rules relating to mortgage credit certificates.

[T.D. 8023, 50 FR 19355, May 8, 1985]

§ 1.163-7 Deduction for OID on certain debt instruments.

(a) *General rule.* Except as otherwise provided in paragraph (b) of this section, an issuer (including a transferee) determines the amount of OID that is deductible each year under section 163(e)(1) by using the constant yield method described in § 1.1272-1(b). This determination, however, is made without regard to section 1272(a)(7) (relating to acquisition premium) and § 1.1273-1(d) (relating to de minimis OID). An issuer is permitted a deduction under section 163(e)(1) only to the extent the issuer is primarily liable on the debt instrument. For certain limitations on the deductibility of OID, see sections 163(e) and 1275(b)(2). To determine the amount of interest (OID) that is deductible each year on a debt in-

strument that provides for contingent payments, see § 1.1275-4.

(b) *Special rules for de minimis OID—(1) Stated interest.* If a debt instrument has a de minimis amount of OID (within the meaning of § 1.1273-1(d)), the issuer treats all stated interest on the debt instrument as qualified stated interest. See §§ 1.446-2(b) and 1.461-1 for the treatment of qualified stated interest.

(2) *Deduction of de minimis OID on other than a constant yield basis.* In lieu of deducting de minimis OID under the general rule of paragraph (a) of this section, an issuer of a debt instrument with a de minimis amount of OID (other than a de minimis amount treated as qualified stated interest under paragraph (b)(1) of this section) may choose to deduct the OID at maturity, on a straight-line basis over the term of the debt instrument, or in proportion to stated interest payments. The issuer makes this choice by reporting the de minimis OID in a manner consistent with the method chosen on the issuer's timely filed Federal income tax return for the taxable year in which the debt instrument is issued.

(c) *Deduction upon repurchase.* Except to the extent disallowed by any other section of the Internal Revenue Code (e.g., section 249) or this paragraph (c), if a debt instrument is repurchased by the issuer for a price in excess of its adjusted issue price (as defined in § 1.1275-1(b)), the excess (repurchase premium) is deductible as interest for the taxable year in which the repurchase occurs. If the issuer repurchases a debt instrument in a debt-for-debt exchange, the repurchase price is the issue price of the newly issued debt instrument (reduced by any unstated interest within the meaning of section 483). However, if the issue price of the newly issued debt instrument is determined under either section 1273(b)(4) or section 1274, any repurchase premium is not deductible in the year of the repurchase, but is amortized over the term of the newly issued debt instrument in the same manner as if it were OID.

(d) *Choice of accrual periods to determine whether a debt instrument is an applicable high yield discount obligation (AHYDO).* Section 163(e)(5) affects an issuer's OID deductions for certain high yield debt instruments that have