

each obligation (if known to or reasonably ascertainable by him). If the obligation held by the taxpayer is an obligation of the United States received from the United States in an exchange upon which gain or loss is not recognized because of section 1037 (a) (or so much of section 1031 (b) or (c) as relates to section 1037(a)), the taxpayer shall keep sufficient records to determine the issue price of such obligation for purposes of applying section 1037(b) and paragraphs (a) and (b) of § 1.1037-1 upon the disposition or redemption of such obligation. The issuer (or in the case of obligations first sold to the public through an underwriter or wholesaler, the underwriter or wholesaler) shall mark the issue price and issue date upon every obligation which is issued at an original issue discount after September 26, 1957, but only if the period between the date of original issue (as defined in paragraph (b)(3) of this section) and the stated maturity date is more than 6 months.

[T.D. 6500, 25 FR 12008, Nov. 26, 1960, as amended by T.D. 6984, 33 FR 19176, Dec. 21, 1968; T.D. 7154, 36 FR 25000, Dec. 28, 1971; 37 FR 527, Jan. 13, 1972; T.D. 7213, 37 FR 21992, Oct. 18, 1972; 37 FR 22863, Oct. 26, 1972; T.D. 7663, 44 FR 76782, Dec. 28, 1979; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1232-3A Inclusion as interest of original issue discount on certain obligations issued after May 27, 1969.

(a) *Ratable inclusion as interest*—(1) *General rule.* Under section 1232(a)(3), the holder of any obligation issued by a corporation after May 27, 1969 (other than an obligation issued by or on behalf of the United States or a foreign country, or a political subdivision of either) shall include as interest in his gross income an amount equal to the ratable monthly portion of original issue discount multiplied by the sum of the number of complete months and any fractional part of a month such holder held the obligation during the taxable year. For increase in basis for amounts included as interest in gross income pursuant to this paragraph, see paragraph (c) of this section. For requirements for reporting original issue discount, see section 6049(a) and the regulations thereunder.

(2) *Ratable monthly portion of original issue discount*—(i) *General rule.* Except when subdivision (ii) of this subparagraph applies, the term *ratable monthly portion of original issue discount* means an amount equal to the original issue discount divided by the sum of the number of complete months (plus any fractional part of a month) beginning on the date of original issue and ending the day before the stated maturity date of such obligation.

(ii) *Reduction for purchase allowance.* With respect to an obligation which has been acquired by purchase (within the meaning of subparagraph (4) of this paragraph), the term *ratable monthly portion of original issue discount* means the lesser of the amount determined under subdivision (i) of this subparagraph or an amount equal to:

(a) The excess (if any) of the stated redemption price of the obligation at maturity over its cost to the purchaser divided by

(b) The sum of the number of complete months (plus any fractional part of a month) beginning on the date of such purchase and ending the day before the stated maturity date of such obligation.

The amount of the ratable monthly portion within the meaning of this subdivision reflects a purchase allowance provided under section 1232(a)(3)(B) where a purchase is made at a price in excess of the sum of the issue price plus the portion of original issue discount previously includible (regardless of whether included) in the gross income of all previous holders (computed, however, as to such previous holders without regard to any purchase allowance under this subdivision and without regard to whether any previous holder purchased at a premium).

(iii) *Ratable monthly portion upon carryover to new obligation.* In any case in which there is a carryover of original issue discount under paragraph (b)(1)(iv) of § 1.1232-3 from an obligation exchanged to an obligation received in such exchange, the ratable monthly portion of original issue discount in respect of the obligation received shall be computed by dividing the amount of original issue discount carried over by the sum of the number of complete months (plus any fractional part of a

month) beginning on the date of the exchange and ending the day before the stated maturity date of the obligation received.

(iv) *Cross references.* For definitions of the terms *original issue discount* and *date of original issue*, see subparagraphs (1) and (3) respectively, of § 1.1232-3(b). For definition of the term *premium*, see paragraph (d)(2) of § 1.1232-3.

(3) *Determination of number of complete months—(i) In general.* For purposes of this section:

(a) A complete month and a fractional part of a month commence with the date of original issue and the corresponding day of each succeeding calendar month (or the last day of a calendar month in which there is no corresponding day),

(b) If an obligation is acquired on any day other than the date a complete month commences, the ratable monthly portion of original issue discount for the complete month in which the acquisition occurs shall be allocated between the transferor and the transferee in accordance with the number of days in such complete month each held the obligation,

(c) In determining the allocation under (b) of this subdivision, any holder may treat each month as having 30 days,

(d) The transferee, and not the transferor, shall be deemed to hold the obligation during the entire day on the date of acquisition, and

(e) The obligor will be treated as the transferee on the date of redemption.

(ii) *Example.* The provisions of this subparagraph may be illustrated by the following example:

Example: On February 22, 1970, A acquires an obligation of X Corporation for which February 1, 1970, is the date of original issue. B acquires the obligation on June 16, 1970. A does not choose to treat each month as having 30 days. Thus, A held the obligation for $3\frac{3}{4}$ months during 1970, i.e., one-fourth of February ($\frac{7}{28}$ days), March, April, May, one-half of June ($\frac{15}{30}$ days). The ratable monthly portion of original issue discount for the obligation is multiplied by $3\frac{3}{4}$ months to determine the amount included in A's gross income for 1970 pursuant to this paragraph.

(4) *Purchase.* For purposes of this section, the term *purchase* means any acquisition (including an acquisition upon original issue) of an obligation to

which this section applies, but only if the basis of such obligation is not determined in whole or in part by reference to the adjusted basis of such obligation in the hands of the person from whom it was acquired or under section 1014(a) (relating to property acquired from a decedent).

(b) *Exceptions—(1) Binding commitment.* Section 1232(a)(3) shall not apply to any obligation issued pursuant to a written commitment which was binding on May 27, 1969, and at all times thereafter.

(2) *Exception for 1-year obligations.* Section 1232(a)(3) shall not apply to any obligation in respect of which the period between the date of original issue (as defined in paragraph (b)(3) of § 1.1232-3) and the stated maturity date is 1 year or less. In such case, gain on the sale or exchange of such obligation shall be included in gross income as interest to the extent the gain does not exceed an amount equal to the ratable monthly portion of original issue discount multiplied by the sum of the number of complete months and any fractional part of a month such taxpayer held such obligation.

(3) *Purchase at a premium.* Section 1232(a)(3) shall not apply to any holder who purchased the obligation at a premium (within the meaning of paragraph (d)(2) of § 1.1232-3).

(4) *Life insurance companies.* Section 1232(a)(3) shall not apply to any holder which is a life insurance company to which section 818(b) applies. However, ratable inclusion of original issue discount as interest under section 1232(a)(3) is required by an insurance company which is subject to the tax imposed by section 821 or 831.

(c) *Basis adjustment.* The basis of an obligation in the hands of the holder thereof shall be increased by any amount of original issue discount with respect thereto included as interest in his gross income pursuant to paragraph (a) of this section. See section 1232(a)(3)(E). However, the basis of an obligation shall not be increased by any amount that was includible as interest in gross income under paragraph (a) of this section, but was not actually included by the holder in his gross income.

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(d) *Examples.* The provisions of paragraphs (a) through (c) of this section may be illustrated by the following examples:

Example 1. On January 1, 1970, A, a calendar-year taxpayer, purchases at original issue, for cash of \$7,600, M Corporation's 10-year, 5-percent bond which has a stated redemption price of \$10,000. The ratable monthly portion of original issue discount, as determined under section 1232(a)(3) and this section, to be included as interest in A's gross income for each month he holds such bond is \$20, computed as follows:

Original issue discount (stated redemption price, \$10,000, minus issue price, \$7,600)	\$2,400	
Divide by: Number of months from date of original issue to stated maturity date	120	months
Ratable monthly portion	\$20	

Assume that A holds the bond for all of 1970 and 1971 and includes as interest in his gross income for each such year an amount equal to the ratable monthly portion, \$20, multiplied by the number of months he held the bond each such year, 12 months, or \$240. Accordingly, on January 1, 1972, A's basis in the bond will have increased under paragraph (c) of this section by the amount so included, \$480 (i.e., \$240×2), from his cost, \$7,600, to \$8,080. For results if A sells the bond on that date, see examples (1) and (2) of paragraph (a)(2) of § 1.1282-3.

Example 2. Assume the same facts as in example (1). Assume further that on January 1, 1972, A sells the bond to B, a calendar-year taxpayer for \$9,040.

Since B purchased the bond, he determines under paragraph (a)(2)(ii) of this section the amount of the ratable monthly portion he must include as interest in his gross income in order to reflect the amount of his purchase allowance (if any). B determines that his ratable monthly portion is \$10, computed as follows:

(1) Stated redemption price at maturity	\$10,000	
(2) Minus: B's cost	\$9,040	
(3) Excess	\$960	
(4) Divide by: Number of months from date of purchase to stated maturity date	96	months
(5) Tentative ratable monthly portion	\$10	
(6) Ratable monthly portion as computed in example (1)	\$20	

Since line (5) is lower than line (6), B's ratable monthly portion is \$10. Accordingly, if B holds the bond for all of 1972, he must include \$120 (i.e., ratable monthly portion, \$10×12 months) as interest in his gross income.

Example 3. (1) Assume the same facts as in example (1). Assume further that on January 1, 1975, A sells the bond to B for \$10,150. Under the exception of paragraph (b)(3) of this section, B is not required to include any amount in respect of original issue discount as interest in his gross income since he has purchased the bond at a premium.

(2) On January 1, 1979, B sells the bond to C, a calendar-year taxpayer, for \$9,940. Since C is now the holder of the bond (and no exception applies to him), he must include as interest in his gross income the ratable monthly portion of original issue discount determined under section 1232(a)(3) and this section. Since C purchased the bond he determines under paragraph (a)(2)(ii) of this section the amount of the ratable monthly portion he must include as interest in his gross income in order to reflect the amount of his purchase allowance (if any). C determines that his ratable monthly portion is \$5, computed as follows:

(1) Stated redemption price at maturity	\$10,000	
(2) Minus: C's cost	\$9,940	
(3) Excess	\$60	
(4) Divide by: Number of months from date of purchase to stated maturity date	12	months
(5) Tentative ratable monthly portion	\$5	
(6) Ratable monthly portion as computed in example (1)	\$20	

Since line (5) is lower than line (6), C's ratable monthly portion is \$5. Accordingly, if C holds the bond for all of 1979, he must include \$60 (i.e., ratable monthly portion, \$5, ×12 months) as interest in his gross income. Upon maturity of the bond on January 1, 1980, C will receive \$10,000 from M, which under paragraph (c) of this section will equal his adjusted basis (the sum of his cost, \$9,940, plus original issue discount included as interest in his gross income, \$60).

Example 4. On January 1, 1968, D, a calendar-year taxpayer, purchases at original issue, for cash of \$8,000, P Corporation's 20-year, 6 percent bond which has a stated redemption price of \$10,000 and which will mature on January 1, 1988. The original issue discount with respect to such bond is \$2,000. However, the ratable inclusion rules of section 1232(a)(3) do not apply to D, since the bond was issued by P before May 28, 1969. On January 1, 1973, pursuant to a plan of reorganization as defined in section 368(a)(1)(E), and in which no gain or loss is recognized by D under section 354, D's 20-year bond is exchanged for a 10-year, 6 percent bond which also has a stated redemption price of \$10,000 but will mature on January 1, 1983. Under paragraph (b)(1)(iv) of § 1.1232-3, the \$2,000 of original issue discount is carried over to the new 10-year bond received in such exchange. Since the new bond is an obligation issued

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after May 27, 1969, D is required to begin ratable inclusion of the \$2,000 of discount as interest in his gross income for 1973. The ratable monthly portion of original issue discount, as determined under section 1232(a)(3) to be included as interest in gross income is computed as follows:

Amount of original issue discount carried over	\$2,000	
Divide by: Number of complete months beginning on January 1, 1973, and ending on December 31, 1982	120	months
Ratable monthly portion	\$16.67	

(e) *Application of section 1232 to certain deposits in financial institutions and similar arrangements*—(1) *In general.* Under paragraph (d) of §1.1232-1, the term *other evidence of indebtedness* includes certificates of deposit, time deposits, bonus plans, and other deposit arrangements with banks, domestic building and loan associations, and similar financial institutions.

(2) *Adjustments where obligation redeemed before maturity*—(i) *In general.* If an obligation described in subparagraph (1) of this paragraph is redeemed for a price less than the stated redemption price at maturity from a taxpayer who acquired the obligation upon original issue, such taxpayer shall be allowed as a deduction, in computing adjusted gross income, the amount of the original issue discount he included in gross income but did not receive (as determined under subdivision (ii) of this subparagraph). The taxpayer's basis of such obligation (determined after any increase in basis for the taxable year under section 1232(a)(3)(E) by the amount of original issue discount included in the holder's gross income under section 1232(a)(3)) shall be decreased by the amount of such adjustment.

(ii) *Computation.* The amount of the adjustment under subdivision (i) of this subparagraph shall be an amount equal to the excess (if any) of (a) the ratable monthly portion of the original issue discount included in the holder's gross income under section 1232(a)(3) for the period he held the obligation, over (b) the excess (if any) of the amount received upon the redemption over the issue price. Under paragraph (b)(1)(iii)(a) of §1.1232-3, if any amount based on a fixed rate of simple or compound interest is actually payable or

will be treated as constructively received under section 451 and the regulations thereunder at fixed periodic intervals of 1 year or less during the term of the obligation, any such amount payable upon redemption shall not be included in determining the amount received upon such redemption.

(iii) *Partial redemption.* (a) In the case of an obligation (other than a single obligation having serial maturity dates), if a portion of the obligation is redeemed prior to the stated maturity date of the entire obligation, the provisions of this subdivision shall be applied and not the provisions of subdivision (ii) of this subparagraph. In such case, the adjusted basis of the unredeemed portion of the obligation on the date of the partial redemption shall be an amount equal to the adjusted basis of the entire obligation on that date minus the amount paid upon the redemption.

(b) If the adjusted basis of the unredeemed portion (as computed under (a) of this subdivision) is equal to or in excess of the amount to be received for the unredeemed portion at maturity, no gain or loss shall be recognized at the time of the partial redemption but the holder shall be allowed a deduction, in computing adjusted gross income for the taxable year during which such partial redemption occurs, equal to the amount of such excess (if any), and no further original issue discount will be includible in the holder's gross income under section 1232(a)(3) over the remaining term of the unredeemed portion. In such case, the holder shall decrease his basis in the unredeemed portion (as computed under (a) of this subdivision) by the amount of such adjustment.

(c) If the adjusted basis of the unredeemed portion (as computed under (a) of this subdivision) is less than the redemption price of the unredeemed portion at maturity, a new computation shall be made under paragraph (a) of this section (without regard to the exception for one-year obligations in paragraph (b)(2) of this section) of the ratable monthly portion of original issue discount to be included as interest in the gross income of the holder over the remaining term of the

unredeemed portion. For purposes of such computation, the adjusted basis of the unredeemed portion shall be treated as the issue price, the date of the partial redemption shall be treated as the issue date, and the amount to be paid for the unredeemed portion at maturity shall be treated as the stated redemption price.

(3) *Examples.* The application of section 1232 to obligations to which this paragraph applies may be illustrated by the following examples:

Example 1. A is a cash method taxpayer who uses the calendar year as his taxable year. On January 1, 1971, he purchases a certificate of deposit from X Bank, a corporation, for \$10,000. The certificate of deposit is not redeemable until December 31, 1975, except in an emergency as defined in, and subject to the qualifications provided by, Regulation Q of the Board of Governors of the Federal Reserve. See 12 CFR 217.4(d). The stated redemption price at maturity is \$13,382.26. The terms of the certificate do not expressly refer to any amount as interest. A's certificate of deposit is an obligation to which section 1232 and this paragraph apply. A shall include the ratable portion of original issue discount in gross income for 1971 as determined under section 1232(a)(3). Thus, if A holds the certificate of deposit for the full calendar year 1971, the amount to be included in A's gross income for 1971 is \$676.45, that is, $\frac{1}{12} \times 6\%$ months, multiplied by the excess of the stated redemption price (\$13,382.26) over the issue price (\$10,000).

Example 2. Assume the same facts as in example (1), except that the certificate of deposit provides for payment upon redemption at December 31, 1975, of an amount equal to "\$10,000, plus 6 percent compound interest from January 1, 1971, to December 31, 1975." Thus, the total amount payable upon redemption in both example (1) and this example is \$13,382.26. The certificate of deposit is an obligation to which section 1232 and this paragraph apply and, since the substance of the deposit arrangement is identical to that contained in example (1), A must include the same amount in gross income.

Example 3. Assume the same facts as in example (1), except that the certificate provides for the payment of interest in the amount of \$200 on December 31, of each year and \$2,000 plus \$10,000 (the original amount) payable upon redemption at December 31, 1975. Thus, if A holds the certificate of deposit for the full calendar year 1971, A must include in his gross income for 1971 the \$200 interest payable on December 31, 1971, and \$400 of original issue discount, that is, $\frac{1}{12} \times 6\%$ months multiplied by the excess of the stated

redemption price (\$12,000) over the issue price (\$10,000).

Example 4. B is a cash method taxpayer who uses the calendar year as his taxable year. On January 1, 1971, B purchases a 4-year savings certificate from the Y Building and Loan Corporation for \$4,000, redeemable on December 31, 1974, for \$5,000. On December 31, 1973, Y redeems the certificate for \$4,660. Under section 1232(a)(3), B included \$250 of original issue discount in his gross income for 1971, \$250 for 1972, and includes \$250 in his gross income for 1973 for a total of \$750. Since the excess of (i) the amount received upon the redemption, \$4,660, over (ii) the issue price, \$4,000, or \$660, is lower than the total amount of original issue discount (\$750) included in B's gross income for the period he held the certificate by \$90, the \$90 will be treated under subparagraph (2) of this paragraph as a deduction in computing adjusted gross income, and accordingly, will decrease the basis of his certificate by such amount. B has no gain or loss upon the redemption, as determined in accordance with the following computation:

Adjusted basis January 1, 1973	\$4,500
Increase under section 1232(a)(3)(E)	250
Subtotal	4,750
Decrease under subparagraph (b)(2) of this paragraph	90
Basis upon redemption	4,660
Amount realized upon redemption	4,660
Gain or loss	0

Example 5. On January 1, 1971, C, a cash method taxpayer who uses the calendar year as his taxable year, opens a savings account in Z bank with a \$10,000 deposit. Under the terms of the account, interest is made available semiannually at 6 percent annual interest, compounded semiannually. Since all of the interest on C's account in Z Bank is made available semiannually, the stated redemption price at maturity under paragraph (b)(1)(iii)(a) of § 1.1232-3 equals the issue price, and, therefore, no original issue discount is reportable by C under section 1232(a)(3). However, C must include the sum of \$300 (i.e., $\frac{1}{2} \times 6\% \times \$10,000$) plus \$309 (i.e., $\frac{1}{2} \times 6\% \times \$10,300$) or \$609, of interest made available during 1971 in his gross income for 1971.

Example 6. (i) D is a cash method taxpayer who uses the calendar year as his taxable year. On January 1, 1971, D purchases a \$10,000 deferred income certificate from M Bank. Under the terms of the certificate, interest accrues at 6 percent per annum, compounded quarterly. The period of the account is 10 years. In addition, the holder is permitted to withdraw the entire amount of the purchase price at any time (but not interest prior to the expiration of the 10 year term), and upon such a withdrawal of the purchase

price, no further interest accrues. If the certificate is held to maturity, the issue price plus accrued interest will aggregate \$18,140.18.

(ii) In respect of the certificate, the original issue discount is \$8,140.18, determined by subtracting the issue price of the certificate (\$10,000) from the stated redemption price at maturity (\$18,140.18). Thus, under section 1232(a)(3) the ratable monthly portion of original issue discount is \$67.835 (i.e., $\frac{1}{20}$ months, multiplied by \$8,140.18). Under section 1232(a)(3), D includes \$814.02 (i.e., 12 months, multiplied by \$67.835) in his gross income for each calendar year the certificate remains outstanding and under section 1232(a)(3)(E) increases his basis by that amount. Thus, on December 31, 1975, D's basis for the certificate is \$14,070.10 (i.e., issue price, \$10,000, increased by product of \$814.02×5 years).

(iii) On December 31, 1975, D withdraws the \$10,000. Under the terms of the certificate \$3,468.55 cannot be withdrawn until December 31, 1980. Under the provisions of subparagraph (2)(iii) of this paragraph, the \$10,000 partial redemption shall be treated as follows:

(1) Adjusted basis of obligation at time of partial redemption	\$14,070.10
(2) Amount paid upon redemption	10,000.00
(3) Adjusted basis of unredeemed portion (line (1) less line (2))	4,070.10
(4) Amount to be paid for unredeemed portion at maturity (December 31, 1980)	3,468.55
(5) Adjustment in computing adjusted gross income (excess of line (3) over line (4))	601.55

Since the adjusted basis of the unredeemed portion exceeds the amount to be received for the unredeemed portion at maturity, D is allowed a deduction, in computing adjusted gross income, of \$601.25 in 1975 and no further original issue discount is includible as interest in his gross income. In addition, D will decrease his basis in the unredeemed portion by \$601.55, the amount of such adjustment, from \$4,070.10 to \$3,468.55.

Example 7. E is a cash method taxpayer who uses the calendar year as his taxable year. On January 1, 1971, E purchases a \$10,000 "Bonus Savings Certificate" from N Building and Loan Corporation. Under the terms of the certificate, interest is payable at 5 percent per annum, compounded quarterly, and the period of the account is 3 years. In addition, the certificate provides that if the holder makes no withdrawals of principal or interest during the term of the certificate, a bonus payment equal to 5 percent of the purchase price of the certificate will be paid to the holder of the certificate at maturity. Thus, the amount of the bonus payment is \$500 (i.e., 5 percent multiplied by \$10,000). Since the 5 percent annual interest is payable quarterly, the amount of such in-

terest is not included in determining the stated redemption price at maturity under paragraph (b)(1)(iii) of § 1.1232-3. However, since the bonus payment is only payable at maturity, the amount of such bonus is included as part of the stated redemption price at maturity. Thus, the stated redemption price at maturity equals \$10,500 (purchase price, \$10,000, plus bonus payment \$500). Accordingly, the original issue discount attributable to such certificate equals \$500 (stated redemption price at maturity, \$10,500, minus issue price, \$10,000). Therefore, E must include as interest \$166.67 (i.e., $\frac{12}{36}$ months, multiplied by the original issue discount, \$500) in his gross income for each taxable year he holds the certificate.

(4) *Renewable certificates of deposit*—(i) *In general.* The renewal of a certificate of deposit shall be treated as a purchase of the certificate on the date the renewal period begins regardless of any requirement pursuant to the terms of the certificate that the holder give notice of an intention to renew or not to renew. Thus, for example, in the case of a certificate of deposit for which a renewal period begins after December 31, 1970, such renewal shall be treated as a purchase after such date whether or not the initial period began before such date.

(ii) *Computation.* For purposes of computing the amount of original issue discount to be ratably included as interest in gross income under section 1232(a)(3) in respect of a renewable certificate of deposit for the initial period or any renewal period, the following rules apply:

(a) The issue price on the date any renewal period begins is considered to be in the case of a certificate of deposit initially purchased:

(1) After December 31, 1970, the adjusted basis of the certificate on the date such period begins,

(2) Before January 1, 1971, the amount the adjusted basis would have been on the date such period begins had the holder included all amounts of original issue discount as interest in gross income that would have been includible if section 1232(a)(3) had applied to the certificate from the date of original purchase.

Thus, if under the terms of the certificate, no amount is forfeited upon a failure to renew, then the issue price on the date any renewal period begins

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is considered to be the amount which would have been received by the holder on such date had it not been renewed.

(b) The date of original issue for any renewal period shall be considered to be the date it begins.

(c) The date of maturity for the initial period or any renewal period shall be considered to be the date it ends.

(d) The stated redemption price at maturity for the initial period or any renewal period shall be considered to be the maximum amount which would be received at the end of any such period, without regard to any reduction resulting from withdrawal prior to maturity or failure to renew at any renewal date.

(iii) *Application of 1-year rule.* For purposes of paragraph (b)(2) of this section (relating to nonapplication of section 1232(a)(3) to any obligation having a term of 1 year or less), the period between the date of original issue (as defined in paragraph (b)(3) of § 1.1232-3) of a renewable certificate of deposit and its stated maturity date shall include all renewal periods with respect to which, under the terms of the certificate, the holder may either take action or refrain from taking action which would prevent the actual or constructive receipt of any interest on such certificate until the expiration of any such renewal period whether or not the original date of issue is prior to January 1, 1971.

(iv) *Example.* The provisions of this subparagraph may be illustrated by the following example:

Example: (a) On May 1, 1969, A purchases a 2-year renewable certificate of deposit from M bank, a corporation, for \$10,000. Interest will be compounded semiannually at 6 percent on May 1 and November 1. The terms of the certificate provide that such certificate will be automatically renewed on the anniversary date every 2 years if the holder does not notify M of an intention not to renew prior to 60 days before the particular anniversary date. Thus, on May 1, 1971, and May 1, 1973, the certificate may be redeemed for \$11,255.09 and \$12,667.60, respectively. However, in no event shall the initial period and the renewal periods exceed 10 years. A does not notify M of an intention not to renew by March 1, 1971, and the certificate is automatically renewed for an additional 2-year period on May 1, 1971.

(b) Under subdivision (i) of this subparagraph, the May 1, 1971, renewal shall be

treated as the purchase of a certificate of deposit on that date, i.e., after December 31, 1970. Under subdivision (ii) of this subparagraph, the issue price is considered to be \$11,255.09 and the date of maturity is considered to be May 1, 1973. Since the stated redemption price at maturity is \$12,667.60. A must include \$58.85 as interest in gross income for each month he holds the certificate during the renewal period beginning May 1, 1971, computed as follows:

Original issue discount (stated redemption price, \$12,667.60, minus issue price, \$11,255.09)	\$1,412.51
Divided by: Number of months from renewal to maturity date	24 months
Ratable monthly portion	\$58.85

(5) *Time deposit open account arrangements*—(i) *In general.* The term *time deposit open account arrangement* means an arrangement with a fixed maturity date where deposits may be made from time to time and ordinarily no interest will be paid or constructively received until such fixed maturity date. All deposits pursuant to such an arrangement constitute parts of a single obligation. The amount of original issue discount to be ratably included as interest in the gross income of the depositor for any taxable year shall be the sum of the amounts separately computed for each deposit. For this purpose, the issue price for a deposit is the amount thereof and the stated redemption price at maturity is computed under paragraph (b)(1)(iii)(d) of § 1.1232-3.

(ii) *Obligations redeemed before maturity.* In the event of a partial redemption of a time deposit open account before maturity, the following rules, in addition to subparagraph (2) of this paragraph, shall apply:

(a) If, pursuant to the terms of the withdrawal, the amount received by the depositor is determined with reference to the principal amount of a specific deposit and interest earned from the date of such deposit, then such terms shall control for the purpose of determining which deposit was withdrawn.

(b) If (a) of this subdivision (ii) does not apply, then the withdrawal shall be deemed to be of specific deposits together with interest earned from the date of such deposits, on a first-in, first-out basis.

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(iii) *Examples.* The provisions of this subparagraph may be illustrated by the following examples:

Example 1. (i) F is a cash method taxpayer who uses the calendar year as his taxable year. On December 1, 1970, F enters into a 5-year deposit open account arrangement with M Savings and Loan Corp. The terms of the arrangement provide that F will deposit \$100 each month for a period of 5 years, and that interest will be compounded semiannually (on June 1 and December 1) at 6 percent, but will be paid only at maturity. Thus, assuming F makes deposits of \$100 on the first of

each month beginning with December 1, 1970, the account will have a stated redemption price of \$6,998.20 at maturity on December 1, 1975. Since, however, section 1232 applies only to deposits made after December 31, 1970 (see paragraph (d) of § 1.1232-1), the \$34.39 of compound interest to be earned on the first deposit of \$100 over the term of the arrangement will not be subject to the ratable inclusion rules of section 1232(a)(3). F must include such \$34.39 of interest in his gross income on December 1, 1975, the date it is paid.

(ii) For 1971, F must include \$44.19 of original issue discount as interest in gross income, to be computed as follows:

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Date of \$100 deposit	Months to maturity	Redemption price at maturity	Original issue discount (Col.3 - \$100)	Ratable monthly portion (Col.4 ÷ Col.2)	Months on deposit in 1971	1971 original issue discount (Col.5 × Col.6)
1-1-71	59	\$133.73	\$33.73	\$0.5717	12	\$6.86
2-1-71	58	133.07	33.07	.5702	11	6.27
3-1-71	57	132.42	32.42	.5688	10	5.69
4-1-71	56	131.77	31.77	.5673	9	5.11
5-1-71	55	131.12	31.12	.5658	8	4.53
6-1-71	54	130.48	30.48	.5644	7	3.95
7-1-71	53	129.84	29.84	.5630	6	3.38
8-1-71	52	129.20	29.20	.5615	5	2.81
9-1-71	51	128.56	28.56	.5600	4	2.24
10-1-71	50	127.93	27.93	.5586	3	1.68
11-1-71	49	127.30	27.30	.5571	2	1.11
12-1-71	48	126.68	26.68	.5558	1	0.56
Total original issue discount to be included as interest in F's gross income for 1971						44.19

Example 2. (i) G is a cash method taxpayer who uses the calendar year as his taxable year. On February 1, 1971, G enters into a 4-year deposit open account arrangement with T Bank, a corporation. The terms of the deposit arrangement provide that G may deposit any amount from time to time in multiples of \$50 for a period of 4 years. The terms also provide that G may not redeem any amount until February 1, 1975, except in an emergency as defined in, and subject to the qualifications provided by, Regulation Q of

the Board of Governors of the Federal Reserve System. See 12 CFR 217.4(d). Interest will be compounded semiannually (on February 1 and August 1) at 6 percent, providing there is no redemption prior to February 1, 1975. However, if there is a redemption prior to such date, interest will be compounded semiannually at 5½ percent.

(ii) The schedule of deposits made by G pursuant to the arrangement, and computation of ratable monthly portion for each deposit, is set forth in the table below:

(1)	(2)	(3)	(4)	(5)	(6)
Date of deposit	Months to maturity	Amount of deposit	Redemption price at maturity	Original issue discount (Col.4 - Col.3)	Ratable monthly portion (Col.5 ÷ Col.2)
2-1-71	48	100	\$126.68	\$26.68	0.5558
6-1-71	44	200	248.42	48.42	1.1005
12-1-71	38	500	602.95	102.95	2.7092
2-1-72	36	800	955.24	155.24	4.3122
3-1-72	35	800	950.56	150.56	4.3017
7-1-72	31	600	699.00	99.00	3.1935
8-1-72	30	250	289.82	39.82	1.3273

(iii) With respect to amounts on deposit pursuant to the arrangement, the amounts of original issue discount G must include as in-

terest in his gross income for 1971 and 1972 are computed in the table below:

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(1)	(2)	(3)	(4)	(5)	(6)
Date of deposit	Ratable monthly portion	Months on deposit in 1971	1971 original issue discount (Col.2× Col.3)	Months on deposit in 1972	1972 original issue discount (Col.2× Col.5)
2-1-71	\$0.5558	11	\$6.11	12	\$6.67
6-1-71	1.1005	7	7.70	12	13.21
12-1-71	2.7092	1	2.71	12	32.51
2-1-72	4.3122	.....	.....	11	47.43
3-1-72	4.3017	.....	.....	10	43.02
7-1-72	3.1935	.....	.....	6	19.16
8-1-72	1.3273	.....	.....	5	6.64
Total original issue discount includible as interest in gross income for taxable year			16.52		168.64

(6) *Certain contingent interest arrangement*—(i) *In general.* If under the terms of a deposit arrangement:

(a) The holder cannot receive payment of any interest or constructively receive any interest prior to a fixed maturity date,

(b) Interest is earned at a guaranteed minimum rate of compound interest,

(c) Additional contingent interest may be earned for any year at a rate not to exceed one percentage point above such guaranteed minimum rate, and

(d) Any additional contingent interest is credited at least annually to the depositor's account,

Then any contingent interest credited to the depositor shall be treated as creating a separate obligation subject to the rules of subdivision (ii) of this subparagraph.

(ii) *Computation.* For purposes of computing the original issue discount to be included as interest in the depositor's gross income under section 1232(a)(3) with respect to such separate obligation:

(a) The issue price shall be zero,

(b) The date of original issue shall be the date on which the contingent interest is credited to the depositor's account and begins to earn interest,

(c) The date of maturity shall be the fixed maturity date of the deposit, and

(d) The stated redemption price at maturity is the sum of the amount of such contingent interest plus any interest to be earned thereon at the guaranteed minimum rate of compound interest between such dates of original issue and maturity.

(7) *Contingent interest arrangements other than those described in subpara-*

graph (6)—(i) *In general.* If under the terms of a deposit arrangement, contingent interest may be earned and credited to a depositor's account, but is neither actually or constructively received before a fixed maturity date nor treated under subparagraph (6)(i) of this paragraph as creating a separate obligation, then the redemption price shall include the amount which would be credited to such account assuming the issuer, during the term of such account, credits contingent interest at the greater of the rate:

(a) Last credited on a similar account, or

(b) Equal to the average rate credited for the preceding 5 calendar years on a similar account.

(ii) *Adjustments for additional interest.*

The rate taken into account under this subparagraph in computing the redemption price shall be treated as the guaranteed minimum rate for purposes of applying subparagraph (6) of this paragraph in the event the rate at which contingent interest is actually credited to the depositor's account exceeds such rate previously taken into account. If for any period the actual rate at which contingent interest is credited to the account exceeds by more than 1 percentage point the rate for the previous period taken into account under this subparagraph in computing the redemption price, a new computation shall be made to determine the ratable monthly portion of original issue discount to be included as interest in the gross income of the depositor over the remaining term of the account. For purposes of such computation, the date that interest is first so credited to the account shall be treated as the issue date, the adjusted

basis of the account on such date shall be the issue price, and the redemption price shall equal the amount actually on deposit in the account on such date plus the amount which would be credited to such account assuming the issuer, during the remaining term of such account, continues to credit contingent interest at the new rate.

(iii) *Adjustment for reduced interest.* If for any period the actual rate of interest at which contingent interest is credited to the depositor's account is less than the rate for the previous period taken into account under this subparagraph in computing the redemption price, the difference between the amount of interest which would have been credited to the account at the rate for such previous period and the amount actually credited shall be allowed as a deduction against the amount of original issue discount with respect to such account required to be included in the gross income of the depositor. If an account is redeemed for a price less than the adjusted basis of the account, the depositor shall be allowed as a deduction, in computing adjusted gross income, the amount of the original issue discount he included in gross income but did not receive.

(f) *Application of section 1232(a)(3) to face-amount certificates—(1) In general.* Under paragraph (c)(3) of § 1.1232-1, the provisions of section 1232(a)(3) and this section apply in the case of a face-amount certificate issued after December 31, 1975 (other than such a certificate issued pursuant to a written commitment which was binding on such date and at all times thereafter).

(2) *Relationship with paragraph (e) of this section.* Determinations with regard to the inclusion as interest of original issue discount on, and certain adjustments with respect to, face-amount certificates to which this section applies shall be made in a manner consistent with the rules of paragraph (e) of this section (relating to the application of section 1232 to certain deposits in financial institutions and similar arrangements). Thus, for example, if a face-amount certificate is redeemed before maturity, the holder shall be allowed a deduction in computing adjusted gross income computed in a manner consistent with the rules

of paragraph (e)(2) of this section. For a further example, if under the terms of a face-amount certificate, the issuer may grant additional credits to be paid at a fixed maturity date, computations with respect to such additional credits shall be made in a manner consistent with the rules of paragraphs (e) (6) and (7) of this section (as applicable) relating to contingent interest arrangements.

[T.D. 7154, 36 FR 25005, Dec. 28, 1971; 37 FR 527, Jan. 13, 1972, as amended by T.D. 7213, 37 FR 21993, Oct. 18, 1972; 37 FR 22863, Oct. 26, 1972; T.D. 7311, 39 FR 11880, Apr. 1, 1974; T.D. 7365, 40 FR 27936, July 2, 1975]

§ 1.1232-4 Obligations with excess coupons detached.

Section 1232(c) provides that if an obligation which is issued at any time with interest coupons:

(a) Is purchased after August 16, 1954, and before January 1, 1958, and the purchaser does not receive all the coupons which first become payable more than 12 months after the date of the purchase, or

(b) Is purchased after December 31, 1957, and the purchaser does not receive all the coupons which first become payable after the date of purchase,

Any gain on the later sale or other disposition of the obligation by the purchaser (or by a transferee of the purchaser whose basis is determined by reference to the basis of the obligation in the hands of the purchaser) shall be treated as ordinary income to the extent that the fair market value of the obligation (determined as of the time of the purchase) with coupons attached exceeds the purchase price. If both the preceding sentence and section 1232(a)(2) apply with respect to the gain realized on the retirement or other disposition of an obligation, then section 1232(a)(2) shall apply only with respect to that part of the gain to which the preceding sentence does not apply. For example, a \$100 bond which sells at \$90 with all its coupons attached is purchased by A for \$80 with 3 years' coupons detached. Three years later, A sells the bond for \$92. The first \$10 of the \$12 profit is taxable as ordinary income. The remaining \$2 gain is taxable either as ordinary income or as long-term capital gain, depending upon the