

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 150.—Definitions and Special Rules

T.D. 9637

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 48

Modification of Treasury Regulations Pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that remove any reference to, or requirement of reliance on, “credit ratings” in regulations under the Internal Revenue Code (Code) and provides substitute standards of credit-worthiness where appropriate. This action is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These regulations affect persons subject to various provisions of the Code.

DATES: *Effective Date:* These regulations are effective on September 6, 2013.

Applicability Dates: For dates of applicability, see §§1.150–1(a)(4), 1.171–1(f), 1.197–2(b)(7), 1.249–1(f)(3), 1.475(a)–4(d)(4), 1.860G–2(g)(3), 1.1001–3(d), (e), and (g), and 48.4101–1(l)(5).

FOR FURTHER INFORMATION CONTACT: Arturo Estrada, (202) 622-3900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 939A(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 (124 Stat. 1376 (2010)) (the “Dodd-Frank Act”), requires each Federal agency to review its

regulations that require the use of an assessment of credit-worthiness of a security or money market instrument, and to review any references or requirements in its regulations regarding credit ratings. Section 939A(b) directs each agency to modify any regulation identified in the review required under section 939A(a) by removing any reference to, or requirement of reliance on, credit ratings and substituting a standard of credit-worthiness that the agency deems appropriate. Numerous provisions under the Internal Revenue Code (Code) are affected.

These regulations amend the Income Tax Regulations (26 CFR part 1) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code (the existing regulations). These sections were added to the Code during different years to serve different purposes. These regulations also amend the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) under section 4101, which provides registration requirements related to Federal fuel taxes.

On July 6, 2011, temporary regulations (TD 9533) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code were published in the **Federal Register** (76 FR 39278) that modify or eliminate the reference to credit ratings in the relevant regulations. Additional temporary regulations (26 CFR part 48) under section 4101 were published as part of TD 9533. A notice of proposed rulemaking (REG–118809–11) cross-referencing the temporary regulations was published in the **Federal Register** the same day (76 FR 39341). No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. The regulations are adopted as proposed without substantive changes.

Explanation of Provisions

These regulations remove references to “credit ratings” and “credit agencies” or functionally similar terms in the existing regulations. Some changes involve simple word deletions or substitutions. Others reflect the revision of one or more sentences to remove the credit rating references.

Where appropriate, substitute standards of credit-worthiness replace the prior references to credit ratings, credit agencies, or functionally similar terms. Language revisions serve solely to remove the references prohibited by section 939A of the Dodd-Frank Act and no additional changes to the existing regulations are intended.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. 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, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. No comments were received.

Drafting Information

These regulations were drafted by personnel in the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of the Associate Chief Counsel (International) and the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 48 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.150-1 is amended as follows:

- 1. Paragraph heading (a)(2) is revised.
2. Paragraph (a)(4) is revised.
3. In paragraph (b), the definition of Issuance costs is revised.

The revisions read as follows:

§1.150-1 Definitions.

(a) * * *

(2) Effective/applicability date * * *
* * * * *

(4) Additional exception to the general applicability date. Section 1.150-1(b), Issuance costs, applies on and after July 6, 2011.

(b) * * *

Issuance costs means costs to the extent incurred in connection with, and allocable to, the issuance of an issue within the meaning of section 147(g). For example, issuance costs include the following costs but only to the extent incurred in connection with, and allocable to, the borrowing: underwriters' spread; counsel fees; financial advisory fees; fees paid to an organization to evaluate the credit quality of an issue; trustee fees; paying agent fees; bond registrar, certification, and authentication fees; accounting fees; printing costs for bonds and offering documents; public approval process costs; engineering and feasibility study costs; guarantee fees, other than for qualified guarantees (as defined in §1.148-4(f)); and similar costs.

* * * * *

§1.150-1T [Removed]

Par. 3. Section 1.150-1T is removed.

Par. 4. Section 1.171-1(f) Example 2 is revised to read as follows:

§1.171-1 Bond premium.

* * * * *

(f) * * *

Example 2. Convertible bond—(i) Facts. On January 1, A purchases for \$1,100 B corporation's bond maturing in three years from the purchase date, with a stated principal amount of \$1,000, payable at maturity. The bond provides for unconditional pay-

ments of interest of \$30 on January 1 and July 1 of each year. In addition, the bond is convertible into 15 shares of B corporation stock at the option of the holder. On the purchase date, B corporation's nonconvertible, publicly-traded, three-year debt of comparable credit quality trades at a price that reflects a yield of 6.75 percent, compounded semiannually.

(ii) Determination of basis. A's basis for determining loss on the sale or exchange of the bond is \$1,100. As of the purchase date, discounting the remaining payments on the bond at the yield at which B's similar nonconvertible bonds trade (6.75 percent, compounded semiannually) results in a present value of \$980. Thus, the value of the conversion option is \$120. Under paragraph (e)(1)(iii)(A) of this section, A's basis is \$980 (\$1,100-\$120) for purposes of this section and §§1.171-2 through 1.171-5. The sum of all amounts payable on the bond other than qualified stated interest is \$1,000. Because A's basis (as determined under paragraph (e)(1)(iii)(A) of this section) does not exceed \$1,000, A does not acquire the bond at a premium.

(iii) Applicability date. Notwithstanding §1.171-5(a)(1), this Example 2 applies to bonds acquired on or after July 6, 2011.

§1.171-1T [Removed]

Par. 5. Section 1.171-1T is removed.

Par. 6. Section 1.197-2 is amended by revising paragraph (b)(7) to read as follows:

§1.197-2 Amortization of goodwill and certain other intangibles.

* * * * *

(b) * * *

(7) Supplier-based intangibles—(i) In general. Section 197 intangibles include any supplier-based intangible. A supplier-based intangible is the value resulting from the future acquisition, pursuant to contractual or other relationships with suppliers in the ordinary course of business, of goods or services that will be sold or used by the taxpayer. Thus, the amount paid or incurred for supplier-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a favorable relationship with persons providing distribution services (such as favorable shelf or display space at a retail outlet), or the existence of favorable supply contracts. The amount paid or incurred for supplier-based intangibles does not include any amount required to be paid for the goods or services themselves pursuant to the terms of the agreement or other

relationship. In addition, see the exceptions in paragraph 2(c) of this section, including the exception in paragraph 2(c)(6) of this section for certain rights to receive tangible property or services from another person.

(ii) Applicability date. This section applies to supplier-based intangibles acquired after July 6, 2011.

* * * * *

§1.197-2T [Removed]

Par. 7. Section 1.197-2T is removed.

Par. 8. Section 1.249-1 is amended by revising paragraphs (e)(2)(ii) and (f)(3) to read as follows:

§1.249-1 Limitation on deduction of bond premium on repurchase.

* * * * *

(e) * * *

(2) * * *

(ii) In determining the amount under paragraph (e)(2)(i) of this section, appropriate consideration shall be given to all factors affecting the selling price or yields of comparable nonconvertible obligations. Such factors include general changes in prevailing yields of comparable obligations between the dates the convertible obligation was issued and repurchased and the amount (if any) by which the selling price of the nonconvertible obligation was affected by reason of any change in the issuing corporation's credit quality or the credit quality of the obligation during such period (determined on the basis of widely published financial information or on the basis of other relevant facts and circumstances which reflect the relative credit quality of the corporation or the comparable obligation).

* * * * *

(f) * * *

(3) Portion of repurchase premium attributable to cost of borrowing. Paragraph (e)(2)(ii) of this section applies to any repurchase of a convertible obligation occurring on or after July 6, 2011.

* * * * *

§1.249-1T [Removed]

Par. 9. Section 1.249-1T is removed.

Par. 10. Section 1.475(a)-4 is amended by revising paragraph (d)(4) Example 1,

Example 2, and Example 3 to read as follows:

§1.475(a)–4 Valuation safe harbor.

* * * * *
(d) * * *
(4) * * *

Example 1. (i) X, a calendar year taxpayer, is a dealer in securities within the meaning of section 475(c)(1). X generally maintains a balanced portfolio of interest rate swaps and other interest rate derivatives, capturing bid-ask spreads and keeping its market exposure within desired limits (using, if necessary, additional derivatives for this purpose). X uses a mark-to-market method on a statement that it is required to file with the United States Securities and Exchange Commission and that satisfies paragraph (d)(2) of this section with respect to both the contracts with customers and the additional derivatives. When determining the amount of any gain or loss realized on a sale, exchange, or termination of a position, X makes a proper adjustment for amounts taken into account respecting payments or receipts. X and all of its counterparties on the derivatives have the same general credit quality as each other.

(ii) Under X's valuation method, as of each valuation date, X determines a mid-market probability distribution of future cash flows under the derivatives and computes the present values of these cash flows. In computing these present values, X uses an industry standard yield curve that is appropriate for obligations by persons with this same general credit quality. In addition, based on information that includes its own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from the general credit quality used in the yield curve to present value the derivatives.

(iii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iv) Applicability date. This Example 1 applies to valuations of securities on or after July 6, 2011.

Example 2. (i) The facts are the same as in Example 1, except that X uses a better credit quality in determining the yield curve to discount the payments to be received under the derivatives. Based on information that includes its own knowledge about the counterparties, X adjusts these present values to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from this better credit quality obligation.

(ii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iii) Applicability date. This Example 2 applies to valuations of securities on or after July 6, 2011.

Example 3. (i) The facts are the same as in Example 1, except that, after computing present values using the discount rates that are appropriate for

obligors with the same general credit quality, and based on information that includes X's own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from a better credit quality.

(ii) X's methodology violates the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once. By using the same general credit quality discount rate, X's method takes into account the difference between risk-free obligations and obligations with that lower credit quality. By adjusting values for the difference between a higher credit quality and that lower credit quality, X takes into account risks that it had already accounted for through the discount rates that it used. The same result would occur if X judged some of its counterparties' obligations to be of a higher credit quality but X failed to adjust the values of those obligations to reflect the difference between a higher credit quality and the lower credit quality.

(iii) Applicability date. This Example 3 applies to valuations of securities on or after July 6, 2011.

* * * * *

§1.475(a)–4T [Removed]

Par. 11. Section 1.475(a)–4T is removed.

Par. 12. Section 1.860G–2 is amended by revising paragraphs (g)(3)(ii)(B), (g)(3)(ii)(C) and (g)(3)(ii)(D) to read as follows:

§1.860G–2 Other rules.

* * * * *
(g) * * *
(3) * * *
(ii) * * *

(B) *Presumption that a reserve is reasonably required.* The amount of a reserve fund is presumed to be reasonable (and an excessive reserve is presumed to have been promptly and appropriately reduced) if it does not exceed the amount required by a third party insurer or guarantor, who does not own directly or indirectly (within the meaning of section 267(c)) an interest in the REMIC (as defined in §1.860D–1(b)(1)), as a condition of providing credit enhancement.

(C) *Presumption may be rebutted.* The presumption in paragraph (g)(3)(ii)(B) of this section may be rebutted if the amounts required by the third party insurer are not commercially reasonable considering the factors described in paragraph (g)(3)(ii)(A) of this section.

(D) *Applicability date.* Paragraphs (g)(3)(ii)(B) and (g)(3)(ii)(C) of this section apply on and after July 6, 2011.

* * * * *

§1.860G–2T [Removed]

Par. 13. Section 1.860G–2T is removed.

Par. 14. Section 1.1001–3 is amended as follows:

1. Paragraph (d) Example 9 is revised.
2. Paragraph (e)(4)(iv)(B) is revised.
3. Paragraph (e)(5)(ii)(B)(2) is revised.
4. Paragraph (g) Examples 1, 5 and 8 are revised.

The revisions read as follows:

§1.1001–3 Modifications of debt instruments.

* * * * *
(d) * * *

Example 9. *Holder's option to increase interest rate.* (i) A corporation issues an 8-year note to a bank in exchange for cash. Under the terms of the note, the bank has the option to increase the rate of interest by a specified amount if certain covenants in the note are breached. The bank's right to increase the interest rate is a unilateral option as described in paragraph (c)(3) of this section.

(ii) A covenant in the note is breached. The bank exercises its option to increase the rate of interest. The increase in the rate of interest occurs by operation of the terms of the note and does not result in a deferral or a reduction in the scheduled payments or any other alteration described in paragraph (c)(2) of this section. Thus, the change in interest rate is not a modification.

(iii) Applicability date. This Example 9 applies to modifications occurring on or after July 6, 2011.

* * * * *
(e) * * *
(4) * * *
(iv) * * *

(B) *Nonrecourse debt instruments (1)* A modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a nonrecourse debt instrument is a significant modification. A substitution of collateral is not a significant modification, however, if the collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and credit quality). In addition, the substitution of a similar commercially available credit enhancement contract is not a significant

modification, and an improvement to the property securing a nonrecourse debt instrument does not result in a significant modification.

(2) *Applicability date.* Paragraph (e)(4)(iv)(B)(I) of this section applies to modifications occurring on or after July 6, 2011.

* * * * *

(5) * * *

(ii) * * *

(B) * * *

(2) *Original collateral (i)* A modification that changes a recourse debt instrument to a nonrecourse debt instrument is not a significant modification if the instrument continues to be secured only by the original collateral and the modification does not result in a change in payment expectations. For this purpose, if the original collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and credit quality), replacement of some or all units of the original collateral with other units of the same or similar type and aggregate value is not considered a change in the original collateral.

(ii) *Applicability date.* Paragraph (e)(5)(ii)(B)(2)(i) of this section applies to modifications occurring on or after July 6, 2011.

* * * * *

(g) * * *

Example 1. Modification of call right. (i) Under the terms of a 30-year, fixed-rate bond, the issuer can call the bond for 102 percent of par at the end of ten years or for 101 percent of par at the end of 20 years. At the end of the eighth year, the holder of the bond pays the issuer to waive the issuer's right to call the bond at the end of the tenth year. On the date of the modification, the issuer's credit quality is approximately the same as when the bond was issued, but market rates of interest have declined from that date.

(ii) The holder's payment to the issuer changes the yield on the bond. Whether the change in yield is a significant modification depends on whether the yield on the modified bond varies from the yield on the original bond by more than the change in yield as described in paragraph (e)(2)(ii) of this section.

(iii) If the change in yield is not a significant modification, the elimination of the issuer's call right must also be tested for significance. Because the specific rules of paragraphs (e)(2) through (e)(6) of this section do not address this modification, the significance of the modification must be determined under the general rule of paragraph (e)(1) of this section.

(iv) *Applicability date.* This *Example 1* applies to modifications occurring on or after July 6, 2011.

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Example 5. Assumption of mortgage with increase in interest rate. (i) A recourse debt instrument

with a 9 percent annual yield is secured by an office building. Under the terms of the instrument, a purchaser of the building may assume the debt and be substituted for the original obligor if the purchaser is equally or more creditworthy than the original obligor and if the interest rate on the instrument is increased by one-half percent (50 basis points). The building is sold, the purchaser assumes the debt, and the interest rate increases by 50 basis points.

(ii) If the purchaser's acquisition of the building does not satisfy the requirements of paragraph (e)(4)(i)(B) or paragraph (e)(4)(i)(C) of this section, the substitution of the purchaser as the obligor is a significant modification under paragraph (e)(4)(i)(A) of this section.

(iii) If the purchaser acquires substantially all of the assets of the original obligor, the assumption of the debt instrument will not result in a significant modification if there is not a change in payment expectations and the assumption does not result in a significant alteration.

(iv) The change in the interest rate, if tested under the rules of paragraph (e)(2) of this section, would result in a significant modification. The change in interest rate that results from the transaction is a significant alteration. Thus, the transaction does not meet the requirements of paragraph (e)(4)(i)(C) of this section and is a significant modification under paragraph (e)(4)(i)(A) of this section.

(v) *Applicability date.* This *Example 5* applies to modifications occurring on or after July 6, 2011.

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Example 8. Substitution of credit enhancement contract. (i) Under the terms of a recourse debt instrument, the issuer's obligations are secured by a letter of credit from a specified bank. The debt instrument does not contain any provision allowing a substitution of a letter of credit from a different bank. The specified bank, however, encounters financial difficulty. The issuer and holder agree that the issuer will substitute a letter of credit from another bank.

(ii) Under paragraph (e)(4)(iv)(A) of this section, the substitution of a different credit enhancement contract is not a significant modification of a recourse debt instrument unless the substitution results in a change in payment expectations. While the substitution of a new letter of credit by a different bank does not itself result in a change in payment expectations, such a substitution may result in a change in payment expectations under certain circumstances (for example, if the obligor's capacity to meet payment obligations is dependent on the letter of credit and the substitution substantially enhances that capacity from primarily speculative to adequate).

(iii) *Applicability date.* This *Example 8* applies to modifications occurring on or after July 6, 2011.

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§1.1001-3T [Removed]

Par. 15. Section 1.1001-3T is removed.

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 16. The authority citation for part 48 continues to read in part as follows:

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

Par. 17. Section 48.4101-1 is amended as follows:

1. Paragraph (f)(4)(ii)(B) is revised.

2. Paragraph (l)(5) is revised.

The revisions read as follows:

§48.4101-1 Taxable fuel; registration.

* * * * *

(f) * * *

(4) * * *

(ii) * * *

(B) *Basis for determination.* The determination under §48.4101-1(f)(4)(ii) must be based on all information relevant to the applicant's financial status.

* * * * *

(l) * * *

(5) *Applicability date.* Paragraph (f)(4)(ii)(B) of this section applies on and after July 6, 2011.

§48.4101-1T [Removed]

Par. 18. Section 48.4101-1T is removed.

Beth Tucker,
Deputy Commissioner for
Operations Support.

Approved August 14, 2013.

Mark J. Mazur,
Assistant Secretary
of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 5, 2013, 8:45 a.m., and published in the issue of the Federal Register for September 6, 2013, 78 F.R. 54758)

Section 6402.—Authority to Make Credits or Refunds

Special administrative procedures for making adjustments or claiming refunds of overpayments of FICA taxes and income tax withholding resulting from *United States v. Windsor* and Rev. Rul. 2013-17, are set forth in Notice 2013-61. See page 432.