

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9561]

RIN 1545-BK46

Treasury Inflation-Protected Securities Issued at a Premium

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance on the tax treatment of Treasury Inflation-Protected Securities issued with more than a de minimis amount of premium. The text of these temporary regulations also serves as the text of the proposed regulations (REG-130777-11) set forth in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective on December 5, 2011.

Applicability Date: For the date of applicability, see §1.1275-7T(k).

FOR FURTHER INFORMATION CONTACT: William E. Blanchard, (202) 622-3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

Treasury Inflation-Protected Securities (TIPS) are securities issued by the Department of the Treasury. The principal amount of a TIPS is adjusted for any inflation or deflation that occurs over the term of the security. The rules for the

taxation of inflation-indexed debt instruments, including TIPS, are contained in §1.1275-7 of the Income Tax Regulations. See also §1.171-3(b) (rules for inflation-indexed debt instruments with bond premium).

The coupon bond method described in §1.1275-7(d) has applied to TIPS rather than the more complex discount bond method described in §1.1275-7(e). Under §1.1275-7(d)(2)(i), however, the coupon bond method is not available with respect to inflation-indexed debt instruments that are issued with more than a de minimis amount of premium (that is, an amount greater than .0025 times the stated principal amount of the security times the number of complete years to the security's maturity).

In Notice 2011-21 (2011-19 IRB 761), to provide a more uniform method for the federal income taxation of TIPS, the Department of the Treasury and the Internal Revenue Service announced that regulations would be issued to provide that taxpayers must use the coupon bond method described in §1.1275-7(d) for TIPS issued with more than a de minimis amount of premium. As a result, the discount bond method described in §1.1275-7(e) would not apply to TIPS issued with more than a de minimis amount of premium. Notice 2011-21 provided that the regulations would be effective for TIPS issued on or after April 8, 2011.

### **Explanation of Provisions**

The temporary regulations in this document contain the rules described in Notice 2011-21. Under the temporary regulations, a taxpayer must use the coupon bond method described in §1.1275-7(d) for a TIPS that is issued with more than a de minimis amount of premium. The temporary regulations contain

an example of how to apply the coupon bond method to a TIPS issued with more than a de minimis amount of premium. As stated in Notice 2011-21, the temporary regulations apply to TIPS issued on or after April 8, 2011. See § 601.601(d)(2)(ii)(b).

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and 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 their impact on small business.

### **Drafting Information**

The principal author of these regulations is William E. Blanchard, Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Amendments to the Regulations**

Accordingly, 26 CFR part 1 is 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 \* \* \*

Section 1.1275-7T also issued under 26 U.S.C. 1275(d). \* \* \*

Par. 2. Section 1.1275-7T is added to read as follows:

### §1.1275-7T Inflation-indexed debt instruments (temporary).

(a) through (h) [Reserved]. For further guidance, see §1.1275-7(a) through (h).

(i) [Reserved]

(j) Treasury Inflation-Protected Securities issued with more than a de minimis amount of premium--(1) Coupon bond method. Notwithstanding §1.1275-7(d)(2)(i), the coupon bond method described in §1.1275-7(d) applies to Treasury Inflation-Protected Securities (TIPS) issued with more than a de minimis amount of premium. For this purpose, the de minimis amount is determined using the principles of §1.1273-1(d).

(2) Example. The following example illustrates the application of the bond premium rules to a TIPS issued with bond premium:

Example. (i) Facts. X, a calendar year taxpayer, purchases at original issuance TIPS with a stated principal amount of \$100,000 and a stated interest rate of .125 percent, compounded semiannually. For purposes of this example, assume that the TIPS are issued in Year 1 on January 1, stated interest is payable on June 30 and December 31 of each year, and that the TIPS mature on December 31, Year 5. X pays \$102,000 for the TIPS, which is the issue price for the TIPS as determined under §1.1275-2(d)(1). Assume that the inflation-adjusted principal amount for the first coupon in Year 1 is \$101,225 (resulting in an interest payment of \$63.27) and for the second coupon in Year 1 is \$102,500 (resulting in an interest payment of \$64.06). X elects to amortize bond premium

under §1.171-4. (For simplicity, contrary to actual practice, the TIPS in this example were issued on the date with respect to which the calculation of the first coupon began.)

(ii) Bond premium. The stated interest on the TIPS is qualified stated interest under §1.1273-1(c). X acquired the TIPS with bond premium of \$2,000 (basis of \$102,000 minus the TIPS' stated principal amount of \$100,000). See §§1.171-1(d), 1.171-3(b), and 1.1275-7(f)(3). The \$2,000 is more than the de minimis amount of premium for the TIPS of \$1,250 (.0025 times the stated principal amount of the TIPS (\$100,000) times the number of complete years to the TIPS' maturity (5 years)). Under paragraph (j)(1) of this section, X must use the coupon bond method to determine X's income from the TIPS.

(iii) Allocation of bond premium. Under §1.171-3(b), the bond premium of \$2,000 is allocable to each semiannual accrual period by assuming that there will be no inflation or deflation over the term of the TIPS. Moreover, for purposes of §1.171-2, the yield of the securities is determined by assuming that there will be no inflation or deflation over their term. Based on this assumption, for purposes of section 171, the TIPS provide for semiannual interest payments of \$62.50 and a \$100,000 payment at maturity. As a result, the yield of the securities for purposes of section 171 is -0.2720 percent, compounded semiannually. Under §1.171-2, the bond premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period (\$62.50 for each accrual period) over the product of the taxpayer's adjusted acquisition price at the beginning of the accrual period (determined without regard to any inflation or deflation) and the taxpayer's yield. Therefore, the \$2,000 of bond premium is allocable to each semiannual accrual period in Year 1 as follows: \$201.22 to the accrual period ending on June 30, Year 1 (the excess of the stated interest of \$62.50 over  $(\$102,000 \times -0.002720/2)$ ); and \$200.95 to the accrual period ending on December 31, Year 1 (the excess of the stated interest of \$62.50 over  $(\$101,798.78 \times -0.002720/2)$ ). The adjusted acquisition price at the beginning of the accrual period ending on December 31, Year 1 is \$101,798.78 (the adjusted acquisition price of \$102,000 at the beginning of the accrual period ending on June 30, Year 1 reduced by the \$201.22 of premium allocable to that accrual period).

(iv) Income determined by applying the coupon bond method and the bond premium rules. Under §1.1275-7(d)(4), the application of the coupon bond method to the TIPS results in a positive inflation adjustment in Year 1 of \$2,500, which is includible in X's income for Year 1. However, because X acquired the TIPS at a premium and elected to amortize the premium, the premium allocable to Year 1 will offset the income on the TIPS as follows: The premium allocable to the first accrual period of \$201.22 first offsets the interest payable for that period of \$63.27. The remaining \$137.95 of premium is treated as a deflation adjustment that offsets the positive inflation adjustment. See §1.171-3(b). The premium allocable to the second accrual period of \$200.95 first offsets the

interest payable for that period of \$64.06. The remaining \$136.89 of premium is treated as a deflation adjustment that further offsets the positive inflation adjustment. As a result, X does not include in income any of the stated interest received in Year 1 and includes in Year 1 income only \$2,225.16 of the positive inflation adjustment for Year 1 (\$2,500 - \$137.94 - \$136.89).

(k) Effective/applicability date. Notwithstanding §1.1275-7(h), this section applies to Treasury Inflation-Protected Securities issued on or after April 8, 2011.

(l) Expiration date. The applicability of this section expires on or before December 2, 2014.

Steven T. Miller  
Deputy Commissioner for Services and Enforcement.

Approved: November 21, 2011

Emily S. McMahon  
Acting Assistant Secretary of the Treasury (Tax Policy).

[4830-1-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-130777-11]

RIN 1545-BK45

Treasury Inflation-Protected Securities Issued at a Premium

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide guidance on the tax treatment of Treasury Inflation-Protected Securities issued with more than a de minimis amount of premium. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by March 5, 2012.

Outlines of topics to be discussed at the public hearing scheduled for March 28, 2012, must be received by March 7, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-130777-11), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-130777-

11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-130777-11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, William E. Blanchard, (202) 622-3950; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Oluwafunmilayo (Funmi) Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background and Explanation of Provisions**

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 1275. The temporary regulations provide that the coupon bond method described in §1.1275-7(d) applies to Treasury Inflation-Protected Securities (TIPS) issued with more than a de minimis amount of premium. The temporary regulations apply to TIPS issued on or after April 8, 2011. The text of the temporary regulations also serves as the text of these proposed regulations. In addition to comments on the text of the temporary regulations, the IRS and the Treasury Department request comments on whether the rules in the temporary regulations should be extended to other types of inflation-indexed debt instruments.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. 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, and 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 Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 28, 2012, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter through the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes

before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the “**FOR FURTHER INFORMATION CONTACT**” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by March 5, 2012 and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 7, 2012. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal author of these regulations is William E. Blanchard, Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income Taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be 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 1.1275-7 is revised to read as follows:

§1.1275-7 Inflation-indexed debt instruments.

[The text of the proposed amendments to §1.1275-7 is the same as the text for §1.1275-7T(i) through (k) published elsewhere in this issue of the **Federal Register**].

Steven T. Miller  
Deputy Commissioner for Services and Enforcement.