- (1) Certain securities previously identified under section 1236.
- (2) Consistency requirement for other securities.
- (b) Corrections on or before January 31, 1994.
 - (1) Purpose.
 - (2) To conform to § 1.475(b)-1(a)
 - (i) Added identifications.
 - (ii) Limitations.
 - (3) To conform to § 1.475(b)-1(c).
- (c) Effect of corrections.
- § 1.475(b)–3 Exemption of securities in certain securitization transactions.
- (a) Exemption of contributed assets.
- (b) Exemption of resulting interests.
 - (1) General rule.
 - (2) Examples.
- § 1.475(b)–4 Exemptions—Identification requirements.
- (a) Identification of the basis for exemption.
- (b) Time for identifying a security with a substituted basis.
- (c) Securities involved in integrated transactions under § 1.1275–6.
 - (1) Definitions.
 - (2) Synthetic debt held by a taxpayer as a result of legging in.
 - (3) Securities held after legging out.
- § 1.475(c)–1 Definitions—Dealer in securities.
- (a) Sellers of nonfinancial goods and services.
- (b) Taxpayers that purchase securities but do not sell more than a negligible portion of the securities.
 - (1) Exemption from dealer status.
 - (2) Negligible portion.
 - (3) Special rules.
- (c) Dealer-customer relationship.
 - (1) [Reserved].
 - (2) Transactions described in section 475(c)(1)(B).
- (d) Issuance of life insurance products.
- § 1.475(c)-2 Definitions—Security.
- (a) In general.
- (b) Negative value REMIC residuals.
- (c) Special rules.
- (d) Synthetic debt held by a taxpayer as a result of an integrated transaction under § 1.1275–6.
- § 1.475(d)-1 Character of gain or loss.
- § 1.475(e)-1 Effective dates.
- (a) Taxable years ending on or after December 31, 1993.
- (b) Taxable years beginning on or after January 1, 1995.
- (c) Securities acquired on or after January 4, 1995.
- (d) Events occurring on or after January 4, 1995
- **Par. 3.** Section 1.475(a)–1 is added to read as follows:

§1.475(a)–1 Mark to market of debt instruments.

(a) Overview. This section provides rules for taking into account interest accruals and gain and loss on a debt instrument to which section 475(a) applies. Paragraph (b) of this section clarifies that the mark-to-market

- computation affects neither the amount treated as interest earned from a debt instrument nor the taxable year in which that interest is taken into account. Paragraph (c) of this section prescribes general rules. Paragraph (d) of this section prescribes additional rules for instruments acquired with market discount. Paragraph (e) of this section provides rules for taking into account market discount that accrued on a bond before the bond became subject to the mark-to-market requirements. Paragraph (f) of this section prescribes rules for computing the mark-to-market gain or loss on partially or wholly worthless debts, and paragraph (g) provides rules for dealers accounting for bad debts using a reserve method of accounting.
- (b) No effect on amount of market discount, acquisition premium, or bond premium. Marking a debt instrument to market does not create, increase, or reduce market discount, acquisition premium, or bond premium, nor does it affect the adjusted issue price of, or accruals of original issue discount (OID) on, a bond issued with OID.
- (c) Accrual of interest, discount, and premium. In general, the amount of gain or loss from marking a debt instrument to market is computed after adjustments to basis for accruals of stated interest, discount, and premium.
- (1) Qualified stated interest. Immediately before a debt instrument is marked to market under section 475(a), the holder of the instrument must take any unpaid accrued qualified stated interest into account and must correspondingly increase the basis of the instrument. The holder must later decrease the basis of the instrument when accrued qualified stated interest is actually received. (See § 1.1273–1(c) for the definition of qualified stated interest and § 1.446–2(b) for the rule governing its accrual.)
- (2) General rule regarding accrual of discount. If a bond that was acquired with OID or market discount is marked to market under section 475(a), then. immediately before the bond is marked to market, the discount accrued through that date (determined under section 1272, 1275(d), or 1276, as applicable) is included in gross income, to the extent not previously included, and the bond's basis is correspondingly increased for amounts so included. (Because accrued OID is determined under all of the rules of section 1272 and the regulations thereunder, it is computed taking into account the reduction for acquisition premium that is required by section 1272(a)(7).) See paragraph (d) of this section, which requires the current inclusion in income of market discount

- on bonds marked to market. See paragraph (e) of this section for exceptions, and additional rules, for market discount bonds that become subject to section 475(a) after acquisition.
- (3) Bond premium. If a debt instrument that is subject to the basis adjustment required by section 1016(a) (5) or (6) is marked to market under section 475(a), then, immediately before the debt instrument is marked to market, the required basis adjustment must be made. Accordingly, the markto-market adjustment is computed after the basis of the debt instrument has been adjusted under section 1016(a) (5) or (6) for disallowed amortizable bond premium (in the case of tax-exempt bonds) or deductible bond premium (in the case of taxable bonds). If an election under section 171(c) is made after the first taxable year in which section 475(a) applies to the bond, the amount of bond premium is determined under section 171(b)(1) without regard to any basis adjustments that may have been required as a result of the bond being marked to market in prior taxable years. See paragraph (b) of this section for the rule that marking a debt instrument to market does not affect bond premium.
- (d) Mandatory current inclusion of market discount—(1) General rule. If section 475(a) applies to a bond during any portion of a taxable year, gross income for that taxable year includes the market discount attributable to the portion of the year to which section 475(a) applies (as determined under section 1276(b)). Section 1276 does not apply to the bond except with respect to market discount, if any, that accrued before the bond became subject to section 475(a). Similarly, section 1277 does not apply to the bond except with respect to any net direct interest expense (as defined in section 1277(c)) that accrued before the bond became subject to section 475(a). See paragraph (e) of this section for additional rules governing this situation. For purposes of the Code other than the purposes described in the last sentence of section 1278(b)(1), any amount included in gross income under this paragraph (d)(1) is treated as interest. The bond's basis is correspondingly increased for any amount so included in gross income.
- (2) Interaction with section 1278(b). Paragraph (d)(1) of this section applies to a dealer, even if the dealer has not elected under section 1278(b) to include market discount currently. If the dealer has not made that election, however, this paragraph (d) does not require current inclusion of market discount on any bond to which section 475(a) does not apply.