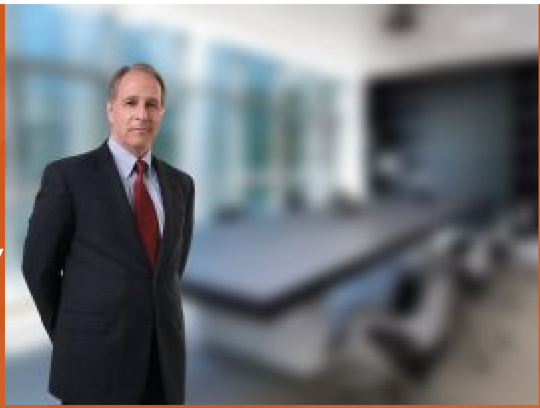

Sales and OID – A Primer

A brief summary of the original issue discount rules of the Internal Revenue Code and the Treasury Regulations as they apply to sales of non-publicly traded property for non-publicly traded debt instruments.

By:Charles A. Wry Jr.
April 18, 2011

This outline summarizes generally the original issue discount (or "OID") rules of the Internal Revenue Code (the "Code") and the Treasury Regulations under the Code (the "Regulations") as they apply to sales of non-publicly traded property for non-publicly traded debt instruments. It is not intended to be an exhaustive analysis of the OID rules, particularly as they apply to, among other things, cash loans, publicly traded instruments, instruments issued for publicly traded property, instruments providing for variable payments, instruments providing for alternate payment schedules, convertible or exchangeable instruments, instruments issued as parts of investment units, instruments providing for the payment of points, instruments providing for payments in kind, instruments providing for certain "teaser rates" or "interest holidays," or instruments that have changed hands after their original issuance.

I. Introduction.

A. Purpose of Rules. The OID rules are set forth in Sections 1272-1275 (and, to a lesser extent, Section 163(e)) of the Code and the Regulations thereunder. If not for the OID rules, cash method lenders and accrual method borrowers might be tempted to "back-load" interest payments so that the lenders include the interest in income only as it is paid while the borrowers deduct the interest as it accrues. In addition, cash method sellers in deferred payment sales might be tempted to avoid characterizing any of their deferred payments as interest to take advantage of capital gain rates and the installment sale rules. Although fairly complicated, the rules are intended simply (i) to identify the portions of the amounts due on a debt instrument that are to be characterized as interest (rather than principal and, in the case of an instrument issued in a sale or exchange of property, amount realized and basis) and (ii) to require that the interest to which the rules apply be taken into account by both the holder and the issuer as it accrues without regard to when it is actually paid.[1]

B. Effect on Seller. From the standpoint of a taxpayer who sells property for a debt instrument, OID is taken into account as ordinary interest income as it accrues and not as part of the amount realized on the sale. In general, any amounts of OID (or interest generally) payable to the seller are backed out before determining the seller's amount realized and in applying the installment sale rules of Code Section 453.

C. Effect on Buyer. From the standpoint of a taxpayer who buys property using a debt instrument, OID (and interest generally) are not part of the cost of the property (for basis or depreciation/amortization purposes). Instead, the buyer deducts the OID under Code Section 163(e) as it accrues (subject to the other provisions of Section 163 and any other deductibility limitations).

To continue reading, please download the PDF.

For more information, please contact the author **Chip Wry**.