

\$1,000, i.e., redemption price, \$100,000, minus issue price, \$99,000. N shall treat \$1,000 as the total amount to be amortized over the life of the bonds.

*Example (2).* Assume the same facts as example (1), except that the bonds are convertible into common stock of N Corporation. Since the issue price of the bonds includes any amount attributable to the conversion privilege, the result is the same as in example (1).

*Example (3).* Assume the same facts as example (1), except that the bonds are issued as part of an investment unit consisting of an obligation and an option. Assume further that the issue price of the bonds as determined under the rules of allocation set forth in paragraph (b)(2)(ii) of §1.1232-3 is \$94,000. The original issue discount on the bond (as determined under section 1232(b)(1) without regard to the one-fourth-of-1-percent limitation in the second sentence thereof) is \$6,000, i.e., redemption price, \$100,000, minus issue price, \$94,000. N shall treat \$6,000 as the total amount to be amortized over the life of the bonds.

*Example (4).* On January 1, 1971, a commercial bank which uses the calendar year as its taxable year, issued a certificate of deposit 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 Regulations 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 certificate is an obligation to which section 1232(a)(3)(A) applies (see paragraph (d) of §1.1232-1), and the original issue discount with respect to the certificate (as determined under section 1232(b)(1) without regard to the one-fourth-of-1-percent limitation in the second sentence thereof) is \$3,382.26 (i.e., redemption price, \$13,382.26, minus issued price, \$10,000). Y shall treat \$3,382.26 as the total amount to be amortized over the life of the certificate.

(c) *Deduction upon repurchase.* (1) Except as provided in subparagraph (2) of this paragraph, if bonds are issued by a corporation and are subsequently repurchased by the corporation at a price in excess of the issue price plus any amount of original issue discount deducted prior to repurchase, or minus any amount of premium returned as income prior to repurchase, the excess of the repurchase price over the issue price adjusted for amortized premium or deducted discount is deductible as interest for the taxable year.

(2) The provisions of subparagraph (1) of this paragraph shall not apply to the extent a deduction is disallowed by sec-

tion 249 (relating to limitation on deduction of bond premium or repurchase of convertible obligation) and the regulations thereunder.

(d) *Effective date.* The provisions of this section shall apply in respect of obligations issued after May 27, 1969, other than—

(1) Obligations issued pursuant to a written commitment which was binding on May 27, 1969, and at all times thereafter, and

(2) Deposits made before January 1, 1971, in the case of certificates of deposit, time deposits, bonus plans, and other deposit arrangements with banks, domestic building and loan associations, and similar financial institutions.

[36 FR 24996, Dec. 28, 1971, as amended by T.D. 7213, 37 FR 21991, Oct. 18, 1972; T.D. 7259, 38 FR 4253, Feb. 12, 1973]

**§ 1.163-5 Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form.**

(a)-(b) [Reserved]

(c) *Obligations issued to foreign persons after September 21, 1984—*(1) *In general.* A determination of whether an obligation satisfies each of the requirements of this paragraph shall be made on an obligation-by-obligation basis. An obligation issued directly (or through affiliated entities) in bearer form by, or guaranteed by, a United States Government-owned agency or a United States Government-sponsored enterprise, such as the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Loan Mortgage Corporation, the Farm Credit Administration, and the Student Loan Marketing Association, may not satisfy this paragraph (c). An obligation issued after September 21, 1984 is described in this paragraph if—

(i) There are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with its original issuance) only to a person who is not a United States person or who is a United States person that is a financial institution (as defined in §1.165-12(c)(1)(v)) purchasing for its own account or for the account of a customer and that agrees to comply with the requirements of section

165(j)(3) (A), (B), or (C) and the regulations thereunder, and

(ii) In the case of an obligation which is not in registered form—

(A) Interest on such obligation is payable only outside the United States and its possessions, and

(B) Unless the obligation is described in subparagraph (2)(i)(C) of this paragraph or is a temporary global security, the following statement in English either appears on the face of the obligation and on any interest coupons which may be detached therefrom or, if the obligation is evidenced by a book entry, appears in the book or record in which the book entry is made: “Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code.” For purposes of this paragraph, the term “temporary global security” means a security which is held for the benefit of the purchasers of the obligations of the issuer and interests in which are exchangeable for securities in definitive registered or bearer form prior to its stated maturity.

(2) *Rules for the application of this paragraph*—(i) *Arrangements reasonably designed to ensure sale to non-United States persons.* An obligation will be considered to satisfy paragraph (c)(1)(i) of this section if the conditions of paragraph (c)(2)(i) (A), (B), (C), or (D) of this section are met in connection with the original issuance of the obligation. An exchange of one obligation for another is considered an original issuance if and only if the exchange constitutes a disposition of property for purposes of section 1001 of the Code. However, an exchange of one obligation for another will not be considered a new issuance if the obligation received is identical in all respects to the obligation surrendered in exchange therefor, except that the obligor of the obligation received need not be the same obligor as the obligor of the obligation surrendered. Obligations that meet the conditions of paragraph (c)(2)(i) (A), (B), (C) or (D) of this section may be issued in a single public offering. The preceding sentence does not apply to certificates of deposit issued under the conditions of para-

graph (c)(2)(i)(C) of this section by a United States person or by a controlled foreign corporation within the meaning of section 957(a) that is engaged in the active conduct of a banking business within the meaning of section 954(c)(3)(B) as in effect prior to the Tax Reform Act of 1986, and the regulations thereunder. A temporary global security need not satisfy the conditions of paragraph (c)(2)(i) (A), (B) or (C) of this section, but must satisfy the applicable requirements of paragraph (c)(2)(i)(D) of this section.

(A) In connection with the original issuance of an obligation, the obligation is offered for sale or resale only outside of the United States and its possessions, is delivered only outside the United States and its possessions and is not registered under the Securities Act of 1933 because it is intended for distribution to persons who are not United States persons. An obligation will not be considered to be required to be registered under the Securities Act of 1933 if the issuer, in reliance on the written opinion of counsel received prior to the issuance thereof, determines in good faith that the obligation need not be registered under the Securities Act of 1933 for the reason that it is intended for distribution to persons who are not United States persons. Solely for purposes of this subdivision (i)(A), the term “United States person” has the same meaning as it has for purposes of determining whether an obligation is intended for distribution to persons under the Securities Act of 1933. Except as provided in paragraph (c)(3) of this section, this paragraph (c)(2)(i)(A) applies only to obligations issued on or before September 7, 1990.

(B) The obligation is registered under the Securities Act of 1933, is exempt from registration by reason of section 3 or section 4 of such Act, or does not qualify as a security under the Securities Act of 1933; all of the conditions set forth in paragraph (c)(2)(i)(B) (1), (2), (3), (4), and (5) of this section are met with respect to such obligations; and, except as provided in paragraph (c)(3) of this section, the obligation is issued on or before September 7, 1990.

(1) In connection with the original issuance of an obligation in bearer form, the obligation is offered for sale

or resale only outside the United States and its possessions.

(2) The issuer does not, and each underwriter and each member of the selling group, if any, covenants that it will not, in connection with the original issuance of the obligation, offer to sell or resell the obligation in bearer form to any person inside the United States or to a United States person unless such United States person is a financial institution as defined in §1.165-12(c)(v) purchasing for its own account or for the account of a customer, which financial institution, as a condition of the purchase, agrees to provide on delivery of the obligation (or on issuance, if the obligation is not in definitive form) the certificate required under paragraph (c)(2)(i)(B)(4).

(3) In connection with its sale or resale during the original issuance of the obligation in bearer form, each underwriter and each member of the selling group, if any, or the issuer, if there is no underwriter or selling group, sends a confirmation to the purchaser of the bearer obligation stating that the purchaser represents that it is not a United States person or, if it is a United States person, it is a financial institution as defined in §1.165-12(c)(v) purchasing for its own account or for the account of a customer and that the financial institution will comply with the requirements of section 165(j)(3) (A), (B), or (C) and the regulations thereunder. The confirmation must also state that, if the purchaser is a dealer, it will send similar confirmations to whomever purchases from it.

(4) In connection with the original issuance of the obligation in bearer form it is delivered in definitive form (or issued, if the obligation is not in definitive form) to the person entitled to physical delivery thereof only outside the United States and its possessions and only upon presentation of a certificate signed by such person to the issuer, underwriter, or member of the selling group, which certificate states that the obligation is not being acquired by or on behalf of a United States person, or for offer to resell or for resale to a United States person or any person inside the United States, or, if a beneficial interest in the obligation is being acquired by a United

States person, that such person is a financial institution as defined in §1.165.12(c)(1)(v) or is acquiring through a financial institution and that the obligation is held by a financial institution that has agreed to comply with the requirements of section 165(j)(3) (A), (B), or (C) and the regulations thereunder and that is not purchasing for offer to resell or for resale inside the United States. When a certificate is provided by a clearing organization, it must be based on statements provided to it by its member organizations. A clearing organization is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation. For purposes of paragraph (c)(2)(i)(B), the term "delivery" does not include the delivery of an obligation to an underwriter or member of the selling group, if any.

(5) The issuer, underwriter, or member of the selling group does not have actual knowledge that the certificate described in paragraph (c)(2)(i)(B)(4) of this section is false. The issuer, underwriter, or member of the selling group shall be deemed to have actual knowledge that the certificate described in paragraph (c)(2)(i)(B)(4) of this section is false if the issuer, underwriter, or member of the selling group has a United States address for the beneficial owner (other than a financial institution as defined in §1.165-12(c)(v) that represents that it will comply with the requirements of section 165(j)(3) (A), (B), or (C) and the regulations thereunder) and does not have documentary evidence as described in §1.6049-5(c)(1) that the beneficial owner is not a United States person.

(C) The obligation is issued only outside the United States and its possessions by an issuer that does not significantly engage in interstate commerce with respect to the issuance of such obligation either directly or through its agent, an underwriter, or a member of the selling group. In the case of an issuer that is a United States person, such issuer may only satisfy the test set forth in this paragraph (c)(2)(i)(C) if—

(1) It is engaged through a branch in the active conduct of a banking business, within the meaning of section 954(c)(3)(B) as in effect before the Tax Reform Act of 1986, and the regulations thereunder, outside the United States;

(2) The obligation is issued outside of the United States by the branch in connection with that trade or business;

(3) The obligation that is so issued is sold directly to the public and is not issued as a part of a larger issuance made by means of a public offering; and

(4) The issuer either maintains documentary evidence as described in subdivision (iii) of A-5 of § 35a.9999-4T that the purchaser is not a United States person (provided that the issuer has no actual knowledge that the documentary evidence is false) or on delivery of the obligation the issuer receives a statement signed by the person entitled to physical delivery thereof and stating either that the obligation is not being acquired by or on behalf of a United States person or that, if a beneficial interest in the obligation is being acquired by a United States person, such person is a financial institution as defined in § 1.165-12(c)(v) or is acquiring through a financial institution and the obligation is held by a financial institution that has agreed to comply with the requirements of 165(j)(3) (A), (B) or (C) and the regulations thereunder and that it is not purchasing for offer to resell or for resale inside the United States (provided that the issuer has no actual knowledge that the statement is false).

In addition, an issuer that is a controlled foreign corporation within the meaning of section 957 (a) that is engaged in the active conduct of a banking business outside the United States within the meaning of section 954(c)(3)(B) as in effect before the Tax Reform Act of 1986, and the regulations thereunder, can only satisfy the provisions of this paragraph (c)(2)(i)(C), if it meets the requirements of this paragraph (c)(2)(i)(C)(2), (3) and (4).

(D) The obligation is issued after September 7, 1990, and all of the conditions set forth in this paragraph (c)(2)(i)(D) are met with respect to such obligation.

(1) *Offers and sales*—(i) *Issuer*. The issuer does not offer or sell the obliga-

tion during the restricted period to a person who is within the United States or its possessions or to a United States person.

(ii) *Distributors*. (A) The distributor of the obligation does not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person.

(B) The distributor of the obligation will be deemed to satisfy the requirements of paragraph (c)(2)(i)(D)(1)(ii)(A) of this section if the distributor of the obligation covenants that it will not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person; and the distributor of the obligation has in effect, in connection with the offer and sale of the obligation during the restricted period, procedures reasonably designed to ensure that its employees or agents who are directly engaged in selling the obligation are aware that the obligation cannot be offered or sold during the restricted period to a person who is within the United States or its possessions or is a United States person.

(iii) *Certain rules*. For purposes of paragraph (c)(2)(i)(D)(1) (i) and (ii) of this section:

(A) An offer or sale will be considered to be made to a person who is within the United States or its possessions if the offeror or seller of the obligation has an address within the United States or its possessions for the offeree or buyer of the obligation with respect to the offer or sale.

(B) An offer or sale of an obligation will not be treated as made to a person within the United States or its possessions or to a United States person if the person to whom the offer or sale is made is: An exempt distributor, as defined in paragraph (c)(2)(i)(D)(5) of this section; An international organization as defined in section 7701(a)(18) and the regulations thereunder, or a foreign central bank as defined in section 895 and the regulations thereunder; or The foreign branch of a United States financial institution as described in paragraph (c)(2)(i)(D)(6)(i) of this section.

Paragraph (c)(2)(i)(D)(1)(iii)(B) regarding an exempt distributor will only apply to an offer to the United States office of an exempt distributor, and paragraph (c)(2)(i)(D)(1)(iii)(B) regarding an international organization or foreign central bank will only apply to an offer to an international organization or foreign central bank, if such offer is made directly and specifically to the United States office, organization or bank.

(C) A sale of an obligation will not be treated as made to a person within the United States or its possessions or to a United States person if the person to whom the sale is made is a person described in paragraph (c)(2)(i)(D)(6)(ii) of this section.

(2) *Delivery.* In connection with the sale of the obligation during the restricted period, neither the issuer nor any distributor delivers the obligation in definitive form within the United States or its possessions.

(3) *Certification—(i) In general.* On the earlier of the date of the first actual payment of interest by the issuer on the obligation or the date of delivery by the issuer of the obligation in definitive form, a certificate is provided to the issuer of the obligation stating that on such date:

(A) The obligation is owned by a person that is not a United States person:

(B) The obligation is owned by a United States person described in paragraph (c)(2)(i)(D)(6) of this section; or

(C) The obligation is owned by a financial institution for purposes of resale during the restricted period, and such financial institution certifies in addition that it has not acquired the obligation for purposes of resale directly or indirectly to a United States person or to a person within the United States or its possessions.

A certificate described in paragraph (c)(2)(i)(D)(3)(i) (A) or (B) of this section may not be given with respect to an obligation that is owned by a financial institution for purposes of resale during the restricted period. For purposes of paragraph (c)(2)(i)(D) (2) and (3) of this section, a temporary global security (as defined in § 1.163-5 (c)(1)(ii)(B)) is not considered to be an obligation in definitive form. If the issuer does not make the obligation available for de-

livery in definitive form within a reasonable period of time after the end of the restricted period, then the obligation shall be treated as not satisfying the requirements of this paragraph (c)(2)(i)(D)(3). The certificate must be signed (or sent, as provided in paragraph (c)(2)(i)(D)(3)(ii) of this section) either by the owner of the obligation or by a financial institution or clearing organization through which the owner holds the obligation, directly or indirectly. For purposes of this paragraph (c)(2)(i)(D)(3), the term “financial institution” means a financial institution described in § 1.165-12(c)(i)(v). When a certificate is provided by a clearing organization, the certificate must be based on statements provided to it by its member organizations. The requirement of this paragraph (c)(1)(D)(3) shall be deemed not to be satisfied with respect to an obligation if the issuer knows or has reason to know that the certificate with respect to such obligation is false. The certificate must be retained by the issuer (and statements by member organizations must be retained by the clearing organization, in the case of certificates based on such statements) for a period of four calendar years following the year in which the certificate is received.

(ii) *Electronic certification.* The certificate required by paragraph (c)(2)(i)(D)(3)(i) of this section (including a statement provided to a clearing organization by a member organization) may be provided electronically, but only if the person receiving such electronic certificate maintains adequate records, for the retention period described in paragraph (c)(2)(i)(D)(3)(i) of this section, establishing that such certificate was received in respect of the subject obligation, and only if there is a written agreement entered into prior to the time of certification (including the written membership rules of a clearing organization) to which the sender and recipient are subject, providing that the electronic certificate shall have the effect of a signed certificate described in paragraph (c)(2)(i)(D)(3)(i) of this section.

(iii) *Exception for certain obligations.* This paragraph (c)(2)(i)(D)(3) shall not apply, and no certificate shall be required, in the case of an obligation

that is sold during the restricted period and that satisfies all of the following requirements:

(A) The interest and principal with respect to the obligation are denominated only in the currency of a single foreign country.

(B) The interest and principal with respect to the obligation are payable only within that foreign country (according to rules similar to those set forth in § 1.163-5(c)(2)(v)).

(C) The obligation is offered and sold in accordance with practices and documentation customary in that foreign country.

(D) The distributor covenants to use reasonable efforts to sell the obligation within that foreign country.

(E) The obligation is not listed, or the subject of an application for listing, on an exchange located outside that foreign country.

(F) The Commissioner has designated that foreign country as a foreign country in which certification under paragraph (c)(2)(i)(D)(3)(i) of this section is not permissible.

(G) The issuance of the obligation is subject to guidelines or restrictions imposed by governmental, banking or securities authorities in that foreign country.

(H) More than 80 percent by value of the obligations included in the offering of which the obligation is a part are offered and sold to non-distributors by distributors maintaining an office located in that foreign country. Foreign currency denominated obligations that are convertible into U.S. dollar denominated obligations or that by their terms are linked to the U.S. dollar in a way which effectively converts the obligations to U.S. dollar denominated obligations do not satisfy the requirements of this paragraph (c)(2)(i)(D)(3)(iii). A foreign currency denominated obligation will not be treated as linked, by its terms, to the U.S. dollar solely because the obligation is the subject of a swap transaction.

(4) *Distributor.* For purposes of this paragraph (c)(2)(i)(D), the term “distributor” means:

(i) A person that offers or sells the obligation during the restricted period

pursuant to a written contract with the issuer;

(ii) Any person that offers or sells the obligation during the restricted period pursuant to a written contract with a person described in paragraph (c)(2)(i)(D)(4)(i); and

(iii) Any affiliate that acquires the obligation from another member of its affiliated group for the purpose of offering or selling the obligation during the restricted period, but only if the transferor member of the group is the issuer or a person described in paragraph (c)(2)(i)(D)(4)(i) or (ii) of this section. The terms “affiliate” and “affiliated group” have the same meanings as in section 1504(a) of the Code, but without regard to the exceptions contained in section 1504(b) and substituting “50 percent” for “80 percent” each time it appears.

For purposes of this paragraph (c)(2)(i)(D)(4), a written contract does not include a confirmation or other notice of the transaction.

(5) *Exempt distributor.* For purposes of this paragraph (c)(2)(i)(D), the term “exempt distributor” means a distributor that covenants in its contract with the issuer or with a distributor described in paragraph (c)(2)(i)(D)(4)(i) that it is buying the obligation for the purpose of resale in connection with the original issuance of the obligation, and that if it retains the obligation for its own account, it will only do so in accordance with the requirements of paragraph (c)(2)(i)(D)(6) of this section. In the latter case, the covenant will constitute the certificate required under paragraph (c)(2)(i)(D)(6). The provisions of paragraph (c)(2)(i)(D)(7) governing the restricted period for unsold allotments or subscriptions shall apply to any obligation retained for investment by an exempt distributor.

(6) *Certain United States persons.* A person is described in this paragraph (c)(2)(i)(D)(6) if the requirements of this paragraph are satisfied and the person is:

(i) The foreign branch of a United States financial institution purchasing for its own account or for resale, or

(ii) A United States person who acquired the obligation through the foreign branch of a United States financial institution and who, for purposes of the certification required in paragraph (c)(2)(i)(D)(3) of this section, holds the obligation through such financial institution on the date of certification.

For purposes of paragraph (c)(2)(i)(D)(6)(ii) of this section, a United States person will be considered to acquire and hold an obligation through the foreign branch of a United States financial institution if the United States person has an account with the United States office of a financial institution, and the transaction is executed by a foreign office of that financial institution, or by the foreign office of another financial institution acting on behalf of that financial institution. This paragraph (c)(2)(i)(D)(6) will apply, however, only if the United States financial institution (or the United States office of a foreign financial institution) holding the obligation provides a certificate to the issuer or distributor selling the obligation within a reasonable time stating that it agrees to comply with the requirements of section 165(j)(3)(A), (B), or (C) and the regulations thereunder. For purposes of this paragraph (c)(2)(i)(D)(6), the term “financial institution” means a financial institution as defined in § 1.165-12(c)(1)(v). As an alternative to the certification required above, a financial institution may provide a blanket certificate to the issuer or distributor selling the obligation stating that the financial institution will comply with the requirements of section 165(j)(3)(A), (B) or (C) and the regulations thereunder. A blanket certificate must be received by the issuer or the distributor in the year of the issuance of the obligation or in either of the preceding two calendar years, and must be retained by the issuer or distributor for at least four years after the end of the last calendar year to which it relates.

(7) *Restricted period.* For purposes of this paragraph (c)(2)(i)(D), the restricted period with respect to an obligation begins on the earlier of the closing date (or the date on which the issuer receives the loan proceeds, if

there is no closing with respect to the obligation), or the first date on which the obligation is offered to persons other than a distributor. The restricted period with respect to an obligation ends on the expiration of the forty day period beginning on the closing date (or the date on which the issuer receives the loan proceeds, if there is no closing with respect to the obligation). Notwithstanding the preceding sentence, any offer or sale of the obligation by the issuer or a distributor shall be deemed to be during the restricted period if the issuer or distributor holds the obligation as part of an unsold allotment or subscription.

(8) *Clearing organization.* For purposes of this paragraph (c)(2)(i)(D), a “clearing organization” is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation.

(ii) *Special rules.* An obligation shall not be considered to be described in paragraph (c)(2)(i)(C) of this section if it is—

(A) Guaranteed by a United States shareholder of the issuer;

(B) Convertible into a debt or equity interest in a United States shareholder of the issuer; or

(C) Substantially identical to an obligation issued by a United States shareholder of the issuer.

For purposes of this paragraph (c)(2)(ii), the term “United States shareholder” is defined as it is defined in section 951 (b) and the regulations thereunder. For purposes of this paragraph (c)(2)(ii)(C), obligations are substantially identical if the face amount, interest rate, term of the issue, due dates for payments, and maturity date of each is substantially identical to the other.

(iii) *Interstate commerce.* For purposes of this paragraph, the term “interstate commerce” means trade or commerce in obligations or any transportation or communication relating thereto between any foreign country and the United States or its possessions.

(A) An issuer will not be considered to engage significantly in interstate commerce with respect to the issuance

of an obligation if the only activities with respect to which the issuer uses the means or instrumentalities of interstate commerce are activities of a preparatory or auxiliary character that do not involve communication between a prospective purchaser and an issuer, its agent, an underwriter, or member of the selling group if either is inside the United States or its possessions. Activities of a preparatory or auxiliary character include, but are not limited to, the following activities:

(1) Establishment or participation in establishment of policies concerning the issuance of obligations and the allocation of funding by a United States shareholder with respect to obligations issued by a foreign corporation or by a United States office with respect to obligations issued by a foreign branch;

(2) Negotiation between the issuer and underwriters as to the terms and pricing of an issue;

(3) Transfer of funds to an office of an issuer in the United States or its possessions by a foreign branch or to a United States shareholder by a foreign corporation;

(4) Consultation by an issuer with accountants and lawyers or other financial advisors in the United States or its possessions regarding the issuance of an obligation;

(5) Document drafting and printing; and

(6) Provision of payment or delivery instructions to members of the selling group by an issuer's office or agent that is located in the United States or its possessions.

(B) Activities that will not be considered to be of a preparatory or auxiliary character include, but are not limited to, any of the following activities:

(1) Negotiation or communication between a prospective purchaser and an issuer, its agent, an underwriter, or a member of the selling group concerning the sale of an obligation if either is inside the United States or its possessions;

(2) Involvement of an issuer's office, its agent, an underwriter, or a member of the selling group in the United States or its possessions in the offer or sale of a particular obligation, either directly with the prospective pur-

chaser, or through the issuer in a foreign country;

(3) Delivery of an obligation in the United States or its possessions; or

(4) Advertising or otherwise promoting an obligation in the United States or its possessions.

(C) The following examples illustrate the application of this subdivision (iii) of § 1.163-5(c)(2).

*Example (1).* Foreign corporation A, a corporation organized in and doing business in foreign country Z, and not a controlled foreign corporation within the meaning of section 957(a) that is engaged in the conduct of a banking business within the meaning of section 954(c)(3)(B) as in effect before the Tax Reform Act of 1986, issues its debentures outside the United States. The debentures are not guaranteed by a United States shareholder of A, nor are they convertible into a debt or equity interest of a United States shareholder of A, nor are they substantially identical to an obligation issued by a United States shareholder of A. A consults its accountants and lawyers in the United States for certain securities and tax advice regarding the debt offering. The underwriting and selling group in respect to A's offering is composed entirely of foreign securities firms, some of which are foreign subsidiaries of United States securities firms. A U.S. affiliate of the foreign underwriter communicates payment and delivery instructions to the selling group. All offering circulars for the offering are mailed and delivered outside the United States and its possessions. All debentures are delivered and paid for outside the United States and its possessions. No office located in the United States or in a United States possession is involved in the sale of debentures. Interest on the debentures is payable only outside the United States and its possessions. A is not significantly engaged in interstate commerce with respect to the offering.

*Example (2).* B, a United States bank, does business in foreign country X through a branch located in X. The branch is a staffed and operating unit engaged in the active conduct of a banking business consisting of one or more of the activities set forth in § 1.954-2(d)(2)(ii). As part of its ongoing business, the branch in X issues negotiable certificates of deposit with a maturity in excess of one year to customers upon request. The certificates of deposit are not guaranteed by a United States shareholder of B, nor are they convertible into a debt or equity interest of a United States shareholder of B, nor are they substantially identical to an obligation issued by a United States shareholder of B. Policies regarding the issuance of negotiable certificates of deposit and funding allocations for foreign branches are set in the



United States at B's main office. Branch personnel decide whether to issue a negotiable certificate of deposit based on the guidelines established by the United States offices of B, but without communicating with the United States offices of B with respect to the issuance of a particular obligation. Negotiable certificates of deposits are delivered and paid for outside the United States and its possessions. Interest on the negotiable certificates of deposit is payable only outside the United States and its possessions. B maintains documentary evidence described in § 1.163-5(c)(2)(i)(C)(4). After the issuance of negotiable certificates of deposit by the foreign branch of B, the foreign branch sends the funds to a United States branch of B for use in domestic operations. B is not significantly engaged in interstate commerce with respect to the issuance of such obligation.

*Example (3).* The facts in Example (2) apply except that the foreign branch of B consulted, by telephone, the main office in the United States to request approval of the issuance of the certificate of deposit at a particular rate of interest. The main office granted permission to issue the negotiable certificate of deposit to the customer by a telex sent from the main office of B to the branch in X. B is significantly engaged in interstate commerce with respect to the issuance of the obligation as a result of involvement of B's United States office in the issuance of the obligation.

*Example (4).* The facts in Example (2) apply with the additional fact that a customer contacted the foreign branch of B through a telex originating in the United States or its possessions. Subsequent to the telex, the foreign branch issued the negotiable certificate of deposit and recorded it on the books. B is significantly engaged in interstate commerce with respect to the issuance of the obligation as a result of its communication by telex with a customer in the United States.

(iv) *Possessions.* For purposes of this section, the term "possessions" includes Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, Wake Island, and Northern Mariana Islands.

(v) *Interest payable outside of the United States.* Interest will be considered payable only outside the United States and its possessions if payment of such interest can be made only upon presentation of a coupon, or upon making of any other demand for payment, outside of the United States and its possessions to the issuer or a paying agent. The fact that payment is made by a draft drawn on a United States bank account or by a wire or other electronic transfer from a United States account does not affect this re-

sult. Interest payments will be considered to be made within the United States if the payments are made by a transfer of funds into an account maintained by the payee in the United States or mailed to an address in the United States, if—

(A) The interest is paid on an obligation issued by either a United States person, a controlled foreign corporation as defined in section 957 (a), or a foreign corporation if 50 percent or more of the gross income of the foreign corporation from all sources of the 3-year period ending with the close of its taxable year preceding the original issuance of the obligation (or for such part of the period that the foreign corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; and

(B) The interest is paid to a person other than—

(1) A person who may satisfy the requirements of section 165 (j)(3) (A), (B), or (C) and the regulations thereunder; and

(2) A financial institution as a step in the clearance of funds and such interest is promptly credited to an account maintained outside the United States for such financial institution or for persons for which the financial institution has collected such interest.

Interest is considered to be paid within the United States and its possessions if a coupon is presented, or a demand for payment is otherwise made, to the issuer or a paying agent (whether a United States or foreign person) in the United States and its possessions even if the funds paid are credited to an account maintained by the payee outside the United States and its possessions. Interest will be considered payable only outside the United States and its possessions notwithstanding that such interest may become payable at the office of the issuer or its United States paying agent under the following conditions: the issuer has appointed paying agents located outside the United States and its possessions with the reasonable expectation that such paying agents will be able to pay the interest in United States dollars, and the full amount of such payment at the offices of all such paying agents is illegal or

effectively precluded because of the imposition of exchange controls or other similar restrictions on the full payment or receipt of interest in United States dollars. A lawsuit brought in the United States or its possessions for payment of the obligation or interest thereon as a result of a default shall not be considered to be a demand for payment. For purposes of this subdivision (v), interest includes original issue discount as defined in section 1273(a). Therefore, an amount equal to the original issue discount as defined in section 1273(a) is payable only outside the United States and its possessions. The amount of market discount as defined in section 1278(a) does not affect the amount of interest to be considered payable only outside the United States and its possessions.

(vi) *Rules relating to obligations issued after December 31, 1982 and on or before September 21, 1984.* Whether an obligation originally issued after December 31, 1982 and on or before September 21, 1984, or an obligation originally issued after September 21, 1984 pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued after December 31, 1982 and on or before September 21, 1984, is described in section 163(f)(2)(B) shall be determined under the rules provided in § 5f.163-1(c) as in effect prior to its removal. Notwithstanding the preceding sentence, an issuer will be considered to satisfy the requirements of section 163(f)(2)(B) with respect to an obligation issued after December 31, 1982 and on or before September 21, 1984 or after September 21, 1984 pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued after December 31, 1982 and on or before September 21, 1984, if the issuer substantially complied with the proposed regulations provided in § 1.163-5(c), which were published in the FEDERAL REGISTER on September 2, 1983 (48 FR 39953) and superseded by temporary regulations published in the FEDERAL REGISTER on August 22, 1984 (49 FR 33228).

(3) *Effective date*—(i) *In general.* These regulations apply generally to obliga-

tions issued after January 20, 1987. A taxpayer may choose to apply the rules of § 1.163-5(c) with respect to an obligation issued after December 31, 1982 and on or before January 20, 1987. If this choice is made, the rules of § 1.163-5(c) will apply in lieu of § 1.163-5T(c) except that the legend requirement under § 1.163-5(c)(1)(ii)(B) does not apply with respect to a bearer obligation evidenced exclusively by a book entry and that the certification requirement under § 1.163-5T(c)(2)(B)(4) applies in lieu of the certification under § 1.163-5(c)(2)(i)(B)(4).

(ii) *Special rules.* If an obligation is originally issued after September 7, 1990 pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued on or before May 10, 1990, then the issuer may choose to apply either the rules of § 1.163-5(c)(2)(i)(A) or § 1.163-5(c)(2)(i)(B), or the rules of § 1.163-5(c)(2)(i)(D). The issuer of an obligation may choose to apply either the rules of § 1.163-5(c)(2)(i)(A) or (B), or the rules of § 1.163-5(c)(2)(i)(D), to an obligation that is originally issued after May 10, 1990, and on or before September 7, 1990. However, any issuer choosing to apply the rules of § 1.163-5(c)(2)(i)(A) must apply the definition of United States person used for such purposes on December 31, 1989, and must obtain any certificates that would have been required under applicable law on December 31, 1989.

[T.D. 8110, 51 FR 45456, Dec. 19, 1986, as amended by T.D. 8203, 53 FR 17926, May 19, 1988; T.D. 8300, 55 FR 19624, May 10, 1990; T.D. 8734, 62 FR 53416, Oct. 14, 1997]

**§ 1.163-5T Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form (temporary).**

(a)—(c) [Reserved]

(d) *Pass-through certificates.* (1) A pass-through or participation certificate evidencing an interest in a pool of mortgage loans which under subpart E of subchapter J of the Code is treated as a trust of which the grantor is the owner (or similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust) (“pass-through certificate”) is considered to