

that are entered into on or after October 1, 1994, and that are described in paragraph (a) of this section. This consent is granted only for changes for the taxable year containing October 1, 1994. The taxpayer must describe its new methods of accounting in a statement that is included in its Federal income tax return for that taxable year.

[T.D. 8554, 59 FR 36358, July 18, 1994, as amended by T.D. 8653, 61 FR 519, Jan. 8, 1996; T.D. 8674, 61 FR 30138, June 14, 1996; T.D. 8985, 67 FR 12865, Mar. 20, 2002; 67 FR 31955, May 13, 2002]

§ 1.446-5 Debt issuance costs.

(a) *In general.* This section provides rules for allocating debt issuance costs over the term of the debt. For purposes of this section, the term *debt issuance costs* means those transaction costs incurred by an issuer of debt (that is, a borrower) that are required to be capitalized under § 1.263(a)-5. If these costs are otherwise deductible, they are deductible by the issuer over the term of the debt as determined under paragraph (b) of this section.

(b) *Method of allocating debt issuance costs—(1) In general.* Solely for purposes of determining the amount of debt issuance costs that may be deducted in any period, these costs are treated as if they adjusted the yield on the debt. To effect this, the issuer treats the costs as if they decreased the issue price of the debt. See § 1.1273-2 to determine issue price. Thus, debt issuance costs increase or create original issue discount and decrease or eliminate bond issuance premium.

(2) *Original issue discount.* Any resulting original issue discount is taken into account by the issuer under the rules in § 1.163-7, which generally require the use of a constant yield method (as described in § 1.1272-1) to compute how much original issue discount is deductible for a period. However, see § 1.163-7(b) for special rules that apply if the total original issue discount on the debt is *de minimis*.

(3) *Bond issuance premium.* Any remaining bond issuance premium is taken into account by the issuer under the rules of § 1.163-13, which generally require the use of a constant yield method for purposes of allocating bond issuance premium to accrual periods.

(c) *Examples.* The following examples illustrate the rules of this section:

Example 1. (i) On January 1, 2004, X borrows \$10,000,000. The principal amount of the loan (\$10,000,000) is repayable on December 31, 2008, and payments of interest in the amount of \$500,000 are due on December 31 of each year the loan is outstanding. X incurs debt issuance costs of \$130,000 to facilitate the borrowing.

(ii) Under § 1.1273-2, the issue price of the loan is \$10,000,000. However, under paragraph (b) of this section, X reduces the issue price of the loan by the debt issuance costs of \$130,000, resulting in an issue price of \$9,870,000. As a result, X treats the loan as having original issue discount in the amount of \$130,000 (stated redemption price at maturity of \$10,000,000 minus the issue price of \$9,870,000). Because this amount of original issue discount is more than the *de minimis* amount of original issue discount for the loan determined under § 1.1273-1(d) (\$125,000 (\$10,000,000 × .0025 × 5)), X must allocate the original issue discount to each year based on the constant yield method described in § 1.1272-1(b). See § 1.163-7(a). Based on this method and a yield of 5.30%, compounded annually, the original issue discount is allocable to each year as follows: \$23,385 for 2004, \$24,625 for 2005, \$25,931 for 2006, \$27,306 for 2007, and \$28,753 for 2008.

Example 2. (i) Assume the same facts as in *Example 1*, except that X incurs debt issuance costs of \$120,000 rather than \$130,000.

(ii) Under § 1.1273-2, the issue price of the loan is \$10,000,000. However, under paragraph (b) of this section, X reduces the issue price of the loan by the debt issuance costs of \$120,000, resulting in an issue price of \$9,880,000. As a result, X treats the loan as having original issue discount in the amount of \$120,000 (stated redemption price at maturity of \$10,000,000 minus the issue price of \$9,880,000). Because this amount of original issue discount is less than the *de minimis* amount of original issue discount for the loan determined under § 1.1273-1(d) (\$125,000), X does not have to use the constant yield method described in § 1.1272-1(b) to allocate the original issue discount to each year. Instead, under § 1.163-7(b)(2), X can choose to allocate the original issue discount to each year on a straight-line basis over the term of the loan or in proportion to the stated interest payments (\$24,000 each year). X also could choose to deduct the original issue discount at maturity of the loan. X makes its choice by reporting the original issue discount in a manner consistent with the method chosen on X's timely filed federal income tax return for 2004. If X wanted to use the constant yield method, based on a yield of 5.279%, compounded annually, the original issue discount is allocable to each year as follows: \$21,596 for 2004, \$22,736 for 2005,

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\$23,937 for 2006, \$25,200 for 2007, and \$26,531 for 2008.

(d) *Effective date.* This section applies to debt issuance costs paid or incurred for debt instruments issued on or after December 31, 2003.

(e) *Accounting method changes—(1) Consent to change.* An issuer required to change its method of accounting for debt issuance costs to comply with this section must secure the consent of the Commissioner in accordance with the requirements of § 1.446-1(e). Paragraph (e)(2) of this section provides the Commissioner's automatic consent for certain changes.

(2) *Automatic consent.* The Commissioner grants consent for an issuer to change its method of accounting for debt issuance costs incurred for debt instruments issued on or after December 31, 2003. Because this change is made on a cut-off basis, no items of income or deduction are omitted or duplicated and, therefore, no adjustment under section 481 is allowed. The consent granted by this paragraph (e)(2) applies provided—

(i) The change is made to comply with this section;

(ii) The change is made for the first taxable year for which the issuer must account for debt issuance costs under this section; and

(iii) The issuer attaches to its federal income tax return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

[T.D. 9107, 69 FR 464, Jan. 5, 2004]

§ 1.448-1 Limitation on the use of the cash receipts and disbursements method of accounting.

(a)-(f) [Reserved]

(g) *Treatment of accounting method change and timing rules for section 481(a) adjustment—(1) Treatment of change in accounting method.* Notwithstanding any other procedure published prior to January 7, 1991, concerning changes from the cash method, any taxpayer to whom section 448 applies must change its method of accounting in accordance with the provisions of this paragraph (g) and paragraph (h) of this section. In the case of any taxpayer required by this section to change its method of accounting for any taxable year, the

change shall be treated as a change initiated by the taxpayer. The adjustments required under section 481(a) with respect to the change in method of accounting of such a taxpayer shall not be reduced by amounts attributable to taxable years preceding the Internal Revenue Code of 1954. Paragraph (h)(2) of this section provides procedures under which a taxpayer may change to an overall accrual method of accounting for the first taxable year the taxpayer is subject to this section ("first section 448 year"). If the taxpayer complies with the provisions of paragraph (h)(2) of this section for its first section 448 year, the change shall be treated as made with the consent of the Commissioner. Paragraph (h)(3) of this section provides procedures under which a taxpayer may change to other than an overall accrual method of accounting for its first section 448 year. Unless the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year, the taxpayer must comply with the provisions of paragraph (h)(4) of this section. See paragraph (h) of this section for rules to effect a change in method of accounting.

(2) *Timing rules for section 481(a) adjustment—(i) In general.* Except as otherwise provided in paragraphs (g)(2)(ii) and (g)(3) of this section, a taxpayer required by this section to change from the cash method must take the section 481(a) adjustment into account ratably (beginning with the year of change) over the shorter of—

(A) The number of taxable years the taxpayer used the cash method, or

(B) 4 taxable years,

provided the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year.

(ii) *Hospital timing rules—(A) In general.* In the case of a hospital that is required by this section to change from the cash method, the section 481(a) adjustment shall be taken into account ratably (beginning with the year of change) over 10 years, provided the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year.