

## Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations.  
(Also Part I, § 1272(a)(6))

Rev. Proc. 2013-26

### SECTION 1. PURPOSE

This revenue procedure allows a taxpayer to use a safe harbor method of accounting for original issue discount (“OID”) on a pool of credit card receivables for purposes of § 1272(a)(6) of the Internal Revenue Code (“Code”)—the “proportional method.” The proportional method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity (“principal”) of the pool that is paid by cardholders during the period. The proportional method described in this revenue procedure generally produces the same results as the method described in § 1272(a)(6). The revenue procedure also describes the exclusive procedures by which a taxpayer may obtain the Commissioner’s consent to change to the proportional method.

Notice 2011-99, 2011-50 I.R.B. 847 (Dec. 12, 2011), contained a proposed revenue procedure that described the proportional method of accounting. Notice 2011-

99 invited public comments regarding the proposed revenue procedure. The Department of the Treasury and the Internal Revenue Service (“IRS”) considered all comments received, and modified the proposed revenue procedure in response to the comments. The significant changes in this revenue procedure from the proposed revenue procedure are as follows:

(1) The revenue procedure applies to any taxpayer that holds a pool of credit card receivables and is not limited to credit card issuers;

(2) A taxpayer may use the proportional method for amounts treated by the revenue procedure as OID (for example, amounts that otherwise are market discount);

(3) When individual accounts are transferred out of a pool or written off, a taxpayer may attribute to those accounts a portion of a pool’s unaccrued OID that is proportional to their outstanding balances; and

(4) A taxpayer may adopt the proportional method, or change to the proportional method under the automatic consent procedures, for a taxable year that ends on or after December 31, 2012.

## SECTION 2. BACKGROUND

.01 A debt instrument is issued with OID if the instrument’s issue price is less than its stated redemption price at maturity (“SRPM”). Section 1273(a)(1). Under § 1.1273-1(b) of the Income Tax Regulations, the SRPM of a debt instrument is the sum of all payments provided by the debt instrument other than payments of qualified stated interest. In general, qualified stated interest is stated interest that is unconditionally payable in cash, or that is constructively received under § 451, at least annually at a

single fixed rate. Section 1.1273-1(c).

.02 Accruals of OID generally are taken into account over the term of a debt instrument using the constant yield method. See § 1272(a)(3) and § 1.1272-1. The Code provides special rules, however, for certain debt instruments for which the principal is subject to acceleration. See § 1272(a)(6). Under § 1272(a)(6), OID accruals are determined based on a prepayment assumption and a formula involving the present value of all remaining payments under the debt instrument as of the close of the accrual period, payments during the accrual period of amounts included in the SRPM of the debt instrument, and the adjusted issue price of the debt instrument at the beginning of the accrual period (“statutory method”).

.03 The Taxpayer Relief Act of 1997 extended the rules of § 1272(a)(6) to OID on any pool of debt instruments the yield on which may be affected by reason of prepayments, including a pool of credit card receivables. See Pub. L. 105-34, § 1004(a), 1997-4 C.B. 1, 125. However, unlike the debt instruments previously subject to § 1272(a)(6), the balance of a pool of credit card receivables can be increased as well as decreased from one accrual period to the next, which adds complexity in applying the rules of § 1272(a)(6).

.04 The IRS has challenged the methods of accounting for OID on pools of credit card receivables adopted by some taxpayers as not clearly reflecting income. See, for example, Capital One Financial Corp. v. Commissioner, 133 T.C. 136 (2009) (holding, in relevant part, that the model used by the taxpayer for computing OID accruals under § 1272(a)(6) was a reasonable method after some modifications by the

court).

.05 The proportional method of accounting described in this revenue procedure is intended to reduce administrative burdens and controversy for taxpayers and the IRS in computing OID accruals on a pool of credit card receivables under § 1272(a)(6). The proportional method is a simplified method of calculation that generally produces the same results as the statutory method.

.06 Certain credit card fees are treated as creating or increasing the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Proc. 2004-33, 2004-1 C.B. 989 (Commissioner will allow a taxpayer to treat late fees as OID). Other fees, however, do not create or increase the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Rul. 2004-52, 2004-1 C.B. 973 (credit card annual fees do not result in OID).

### SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer holds receivables arising from credit cards that allow cardholders to access a revolving line of credit to purchase goods and services, or to obtain cash advances;

.02 For federal income tax purposes, the credit card purchase transactions of the cardholders do not create debt that is given in consideration for the sale or exchange of property;

.03 The taxpayer maintains one or more pools of receivables with respect to such credit cards (or one or more pools of receivables with respect to such credit cards

are maintained on the taxpayer's behalf); and

.04 In the case of a taxpayer that maintains (or on whose behalf are maintained) more than one pool of credit card receivables, the manner in which pools are established and maintained does not achieve a result that is unreasonable in light of the purposes of §§ 1271 through 1275.

#### SECTION 4. APPLICATION

.01 The proportional method of accounting described in section 5 of this revenue procedure is a permissible method for use by a taxpayer within the scope of this revenue procedure to account for OID on a pool of credit card receivables described in section 3 of this revenue procedure. If the proportional method is used by a taxpayer to account for any pool of credit card receivables, the method must be used for every pool of credit card receivables described in section 3 of this revenue procedure and held by that taxpayer. If the proportional method is used for more than one such pool, separate data for each pool must be kept, and the computations must be made separately based on the data for each pool.

.02 For purposes of this revenue procedure, a taxpayer within the scope of this revenue procedure that acquires a pool of credit card receivables (or an interest in such a pool) may treat the difference between the aggregate balance (or the taxpayer's share of the balance) owed on all credit card receivables included in the pool other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest) and the taxpayer's basis as OID. As a result, a taxpayer may use the proportional method for certain amounts that would not

otherwise be treated as OID, for example, market discount or bond premium.

.03 A taxpayer that wants to change its method of accounting to the proportional method must use the automatic change in method procedures of Rev. Proc. 2011-14, 2011-1 C.B. 330, or its successor, to make the change. See section 8 of this revenue procedure. If a taxpayer changes to the proportional method, the unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the pool. See section 5.02(2) of this revenue procedure. If a taxpayer does not already have a method of accounting for OID (or an amount treated as OID under section 4.02 of this revenue procedure) on any pool of credit card receivables, the taxpayer may adopt the proportional method by using it on a timely filed (including extensions) original federal income tax return for the first taxable year the taxpayer must account for OID on a pool of credit card receivables. A taxpayer may adopt or change its method of accounting to the proportional method for a taxable year that ends on or after December 31, 2012.

## SECTION 5. PROPORTIONAL METHOD OF ACCOUNTING

This section 5 describes the proportional method of accounting for OID on a pool of credit card receivables. Under the method—

.01 The required computations must be made monthly. Thus, the computation period referred to below is a calendar month (or that portion of a month that falls within a short taxable year). A taxpayer that changes its method of accounting to the proportional method must make the required computations for each month in the year of

change by the due date for the taxpayer's timely filed (including extensions) original federal income tax return implementing the change in method of accounting for the year of change.

.02 At the beginning of each computation period, the taxpayer must determine the following information for each pool of credit card receivables:

(1) The SRPM as of the beginning of the period ("Beginning SRPM"), which is equal to the aggregate balance owed on all credit card receivables included in the pool at the beginning of such period, other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest).

(2) The unaccrued OID as of the beginning of the period ("Beginning OID"), which is equal to the OID with respect to the pool at the beginning of such period that has not previously been taken into income.

.03 During each computation period, the taxpayer must determine for each pool of credit card receivables the sum of the payments during the period of amounts that reduce the Beginning SRPM for the period ("SRPM Payments") (equivalently, total payments less amounts that are not included in SRPM, such as charges or fees that are not properly treated as OID).

.04 For each computation period, the taxpayer must compute the OID allocated to the period ("Monthly OID") and include this amount in income for the period. Monthly OID is the product of (1) the Beginning OID multiplied by (2) the quotient of the SRPM Payments divided by the Beginning SRPM.

.05 The formula in section 5.04 of this revenue procedure can be restated as follows:

$$M\_OID = BEG\_OID * (SRPM\_P / BEG\_SRPM),$$

where

M\_OID = Monthly OID;

BEG\_OID = Beginning OID;

SRPM\_P = SRPM Payments; and

BEG\_SRPM = Beginning SRPM.

.06 For purposes of determining the Beginning SRPM and Beginning OID for a period, the taxpayer should take into account the following items:

- (1) The charges and fees relating to the pool for the preceding period that are properly treated as OID;
- (2) Credit card accounts transferred into the pool during the preceding period, including any unaccrued OID attributable to the accounts;
- (3) Credit card accounts transferred out of the pool during the preceding period, including any unaccrued OID attributable to the accounts; and
- (4) Credit card accounts written off during the preceding period, including any unaccrued OID attributable to the accounts.

.07 For purposes of sections 5.06(3) and 5.06(4) of this revenue procedure, the taxpayer may determine the unaccrued OID attributable to an account in a pool as the portion of the unaccrued OID attributable to the pool as of the beginning of the preceding period that is proportional to the SRPM of the account as of the beginning of

the preceding period.

.08 If the taxpayer transfers credit card accounts from one of its pools into another one of its pools, the unaccrued OID transferred out of the first pool must be equal to the unaccrued OID transferred into the second pool.

.09 In the case of a pool wholly owned by two or more members of an affiliated group of corporations that file a consolidated return for federal income tax purposes, the members of the group may apply the proportional method to the entire pool and then allocate the OID among the owners, provided that the OID is allocated using a reasonable method. For example, an allocation in proportion to the SRPM attributable to the members' interests in the pool is reasonable.

.10 Section 1.6001-1(a) of the Procedure and Administration Regulations provides that any person subject to tax under subtitle A of the Code shall keep such permanent books of account or records to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax. To satisfy the recordkeeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the proportional method of accounting should maintain records supporting all aspects of its method, including, but not limited to, the computations described in section 5 of this revenue procedure.

## SECTION 6. EXAMPLES

.01 Example 1. (1) On December 1, for the taxpayer's single pool of credit card receivables, the Beginning SRPM is \$100,000,000, and the Beginning OID is \$1,000,000. During December, the taxpayer receives SRPM payments of \$11,000,000

with respect to the pool.

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of \$110,000 ( $\$1,000,000 * (\$11,000,000 / \$100,000,000)$ ).

.02 Example 2. The facts are the same as in Example 1. In addition, during December, credit card activity, charges, and fees relating to the pool add \$14,000,000 to the SRPM and \$300,000 to the unaccrued OID, and the taxpayer writes off credit card accounts whose aggregate balance at the beginning of December is \$50,000. The taxpayer determines that the unaccrued OID attributable to the written-off accounts is \$500 ( $\$1,000,000 * (\$50,000 / \$100,000,000)$ ). As a result, on January 1, the Beginning SRPM is \$102,950,000 ( $\$100,000,000 - \$11,000,000 + \$14,000,000 - \$50,000$ ), and the Beginning OID is \$1,189,500 ( $\$1,000,000 - \$110,000 + \$300,000 - \$500$ ).

## SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years that end on or after December 31, 2012.

## SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011-14 is modified by revising section 31.02 to the APPENDIX to read as follows:

SECTION 31.02. Proportional method of accounting for OID on a pool of credit card receivables

(1) Description of change. This change applies to a taxpayer that wants to change to the proportional method of accounting for OID on a pool of credit card receivables as described in Rev. Proc. 2013-26, 2013-22 I.R.B. xxx. Under Rev. Proc.

2013-26, a taxpayer may use the proportional method of accounting for a taxable year that ends on or after December 31, 2012.

(2) Manner of making change. This change is made on a cut-off basis.

Accordingly, a § 481(a) adjustment is neither required nor permitted. The unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the pool. See section 2.06 of this revenue procedure for more information regarding a cut-off basis.

(3) Waiver of 5-year restriction. The scope limitation in section 4.02(7) of this revenue procedure does not apply to a change to the proportional method of accounting for OID on a pool of credit card receivables, as described in section 5 of Rev. Proc. 2013-26, for the taxpayer's first or second taxable year ending on or after December 31, 2012.

(4) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under section 31.02 of this APPENDIX is "183." See section 6.02(4) of this revenue procedure.

(5) Contact information. For further information regarding this section, please contact Charles W. Culmer at (202) 622-3950 (not a toll-free call).

## SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Charles W. Culmer on (202) 622-3950 (not a

toll free call).