

Part III

Administrative, Procedural, and Miscellaneous

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

Rev. Proc. 2021-35

SECTION 1. PURPOSE

Rev. Proc. 2013-26, 2013-22 I.R.B. 1160, 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." This revenue procedure modifies Rev. Proc. 2013-26 to reflect changes made to the treatment of certain credit card fees by § 451(b) of the Code, as amended by section 13221 of Public Law 115–97 (131 Stat. 2054), commonly referred to as the Tax Cuts and Jobs Act (TCJA), and §§ 1.451-3 and 1.1275-2(l) of the Income Tax Regulations (T.D. 9941, 86 FR 810 (January 6, 2021)).

SECTION 2. BACKGROUND

.01 The Department of Treasury (Treasury Department) and the Internal Revenue Service (IRS) allowed the use of the proportional method in Rev. Proc. 2013-

26 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 generally produces the same results as the statutory method of calculating OID accruals under § 1272(a)(6). The proportional method generally allocates to an accrual period an amount of unaccrued OID for the pool that is proportional to the amount of the stated redemption price at maturity (SRPM) of the pool that is paid by cardholders during the accrual period.

.02 Prior to the enactment of the TCJA, the Treasury Department and the IRS accepted the treatment of certain credit card fees associated with pools of credit card receivables as creating or increasing OID on those pools. See Rev. Proc. 2004-33, 2004-1 C.B. 989 (the IRS will not challenge the treatment of late fees as creating or increasing OID); Rev. Proc. 2005-47, 2005-2 C.B. 269 (the IRS will not challenge the treatment of cash advance fees as creating or increasing OID); and Chief Counsel Notice CC-2010-018, Sept. 27, 2010 (as a result of the Tax Court's decision in *Capital One Financial Corp. and Subsidiaries v. Commissioner*, 133 T.C. 136 (2009), the IRS will no longer challenge or litigate the issue of whether interchange fee income creates or increases OID). Accordingly, for purposes of Rev. Proc. 2013-26, a taxpayer could have treated as OID amounts attributable to certain credit card fees associated with pools of credit card receivables, including credit card late fees, credit card cash advance fees, and interchange fees. In certain circumstances, for purposes of Rev. Proc. 2013-26, a taxpayer may treat as OID certain amounts that would not otherwise be treated as OID (for example, market discount or bond premium). See section 4.02 of Rev. Proc. 2013-26.

.03 On December 22, 2017, § 451(b) was amended by the TCJA to provide that, for an accrual method taxpayer, the all events test for an item of gross income, or portion thereof, is met no later than when the item, or portion thereof, is included as revenue in an applicable financial statement (AFS) (AFS Income Inclusion Rule). With the amendment of § 451(b), Congress overturned the historical Federal income tax treatment of credit card late fees, credit card cash advance fees, and interchange fees by subjecting these fees to the AFS Income Inclusion Rule instead of the timing rules for OID. In particular, the legislative history for the amendment describes credit card late fees, credit card cash advance fees, and interchange fees as examples of amounts to which § 451(b), as amended by the TCJA, would apply. H.R. Rep. No. 115-466, at 429 (2017) (Conf. Rep.).

.04 Section 451(b), as amended by the TCJA, generally applies to taxable years beginning after December 31, 2017. However, in the case of income from a debt instrument having OID, § 451(b), as amended by the TCJA, applies to taxable years beginning after December 31, 2018. In addition, if a taxpayer makes a qualified change in method of accounting as defined in section 13221(d)(2) of the TCJA for income from a debt instrument having OID to comply with § 451(b), as amended by the TCJA, for the taxpayer's first taxable year beginning after December 31, 2018, the § 481(a) adjustment period for the change is six taxable years. See section 13221(e) of the TCJA.

.05 On January 6, 2021, the Treasury Department and the IRS published in the Federal Register (86 FR 810) final regulations under §§ 451(b) and 1275(d). See §§ 1.451-3 and 1.1275-2(l) (final regulations). In general, under the AFS Income

Inclusion Rule in § 1.451-3, an item of income, or portion thereof, may not be included in income later than when that item, or portion thereof, is treated as taken into account as AFS revenue, as determined under § 1.451-3(b)(2). The AFS Income Inclusion Rule, however, does not apply to any item of gross income the recognition of which is determined using a special method of accounting as defined in § 1.451-3(b)(13), which includes, except as otherwise provided in § 1.451-3(j), the timing rules for OID. Section 1.451-3(j) provides that if a fee is not spread over a period of time as discount or as an adjustment to the yield of a debt instrument (such as points) in the taxpayer's AFS, and, but for §§ 1.451-3(j) and 1.1275-2(l), would be treated as creating or increasing OID for Federal income tax purposes (specified fee), then the rules in § 1.451-3 apply before the rules in §§ 1271 through 1275 and the regulations thereunder (the OID rules). Section 1.451-3(j)(2) provides three examples of specified fees: credit card late fees, credit card cash advance fees, and interchange fees (specified credit card fees). To coordinate the OID rules with § 451(b), as amended by the TCJA, and § 1.451-3, § 1.1275-2(l) provides that if, and to the extent, a taxpayer's item of income with respect to a debt instrument is subject to the timing rules in § 1.451-3 because the item of income is a specified fee (including specified credit card fees), then the taxpayer does not take the item into account in determining whether the debt instrument has any OID. As a result, the taxpayer does not treat the item as creating or increasing any OID on the debt instrument. The final regulations do not affect the application of the OID rules to any item that is not a specified fee.

.06 Sections 1.451-3 and 1.1275-2(l) generally apply to taxable years beginning on or after January 1, 2021. However, in the case of a specified fee other than a

specified credit card fee, those sections apply to taxable years beginning on or after January 6, 2022. For a taxable year beginning after December 31, 2018, and before January 1, 2021, a taxpayer and its related parties, within the meaning of §§ 267(b) and 707(b), may choose to apply both §§ 1.451-3 and 1.1275-2(l), in their entirety and in a consistent manner, to all specified credit card fees subject to § 1.451-3, provided that, once applied to a taxable year, the rules in § 1.1275-2(l) and the rules in § 1.451-3 that apply to specified credit card fees, are applied in their entirety and in a consistent manner for all subsequent taxable years.

.07 Based on § 451(b) and the final regulations, Rev. Proc. 2004-33, Rev. Proc. 2005-47, and Chief Counsel Notice CC-2010-018 no longer provide current guidance on the treatment of the specified credit card fees. Accordingly, the Treasury Department and the IRS obsoleted these items as of January 1, 2021. See 86 FR 810, 824 (January 6, 2021).

.08 Because, under § 1.1275-2(l), OID no longer includes an item of income (or portion thereof) that is subject to the timing rules of § 1.451-3 because the item (or portion thereof) is a specified fee, such as a specified credit card fee, Rev. Proc. 2013-26 is modified to avoid confusion as to whether such items (or portions thereof) are fees that are properly treated as OID. Under Rev. Proc. 2013-26, as modified by this revenue procedure, a taxpayer that wants to use the proportional method for calculating OID accruals on a pool of credit card receivables under § 1272(a)(6) may treat as OID only fees or charges that are not subject to the timing rules of § 1.451-3 (for example, promotional discount) and certain amounts that would not otherwise be treated as OID

(for example, market discount or bond premium). See section 4.02 of Rev. Proc. 2013-26.

.09 On December 17, 2018, the Treasury Department and the IRS published Rev. Proc. 2018-60, 2018-51 I.R.B. 1045, which added section 16.12 to the List of Automatic Changes in Rev. Proc. 2018-31, 2018-22 I.R.B. 637, for a taxpayer to change its method of accounting for the timing of income recognition for Federal income tax purposes to comply with § 451(b), as amended by section 13221 of the TCJA, for taxable years beginning after December 31, 2017 (or, in the case of income from a debt instrument having OID, beginning after December 31, 2018). On September 23, 2019, the Treasury Department and the IRS published Rev. Proc. 2019-37, 2019-39 I.R.B. 731, which modified section 16.12 in the List of Automatic Changes in Rev. Proc. 2018-31 to provide procedures for a taxpayer to obtain the automatic consent of the Commissioner of Internal Revenue or his delegate (Commissioner) to make a method change to comply with § 451(b) and proposed § 1.451-3, including changes with respect to specified credit card fees. Concurrent with the release of this revenue procedure, the Treasury Department and the IRS are issuing Rev. Proc. 2021-34, 2021-35 I.R.B. ___, which modifies Rev. Proc. 2019-43, 2019-48 I.R.B. 1107, to provide procedures for a taxpayer to obtain the automatic consent of the Commissioner to change methods of accounting to comply with §§ 1.451-3 and 1.1275-2(l), including a change to exclude items of income that are subject to the timing rules of § 1.451-3 because the items are specified fees, such as the specified credit card fees, from the proportional method. Compliant taxpayers that had been using the proportional method for specified credit card fees generally should have made a change in method of accounting for the

specified credit card fees under either Rev. Proc. 2018-60 or Rev. Proc. 2019-37.

Taxpayers using the proportional method that have not made the required method change may use the procedures provided in Rev. Proc. 2019-43, as modified by Rev. Proc. 2021-34, for changes with respect to specified credit card fees.

SECTION 3. MODIFICATIONS TO REV. PROC. 2013-26

.01 Modification to section 2.06 of Rev. Proc 2013-26. Section 2.06 of Rev. Proc. 2013-26 is modified to read as follows:

.06 Under § 1.1275-2(l), if, and to the extent, a taxpayer's item of income (or portion thereof) with respect to a debt instrument is subject to the timing rules in § 1.451-3 because the item is a specified fee as defined in § 1.451-3(j) (including credit card late fees, credit card cash advance fees, and interchange fees), then the taxpayer does not take the item (or portion thereof) into account to determine whether the debt instrument has any OID. As a result, the taxpayer does not treat the item (or portion thereof) as creating or increasing OID on the pool of credit card receivables to which the item relates. In addition, there are other credit card fees that 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). Certain credit card fees, however, are not subject to the timing rules in § 1.451-3 because they are not specified fees and create or increase the amount of OID on the pool of credit card receivables to which the fees relate. An example of such a fee is promotional discount, which a merchant pays to a credit card issuer in

compensation for a low or zero interest rate on a credit card receivable during a promotional period.

.02 Modification to section 4.01 of Rev. Proc. 2013-26. Section 4.01 of Rev. Proc. 2013-26 is modified by inserting the following two sentences at the end of that section: For purposes of this revenue procedure, OID and SRPM do not include an item of income (or portion thereof) that is subject to the timing rules of § 1.451-3 because the item (or portion thereof) is a specified fee, including a specified credit card fee. See § 1.1275-2(l).

.03 Modification to section 4.02 of Rev. Proc. 2013-26. Section 4.02 of Rev. Proc. 2013-26 is modified by replacing the parenthetical “(such as finance charges that are qualified stated interest)” in the first sentence of that section with the parenthetical “(such as finance charges that are qualified stated interest and specified fees as defined in § 1.451-3(j))”.

.04 Modification to section 4.03 of Rev. Proc. 2013-26. Section 4.03 of Rev. Proc. 2013-26 is modified to read as follows:

.03 A taxpayer changing its method of accounting for OID on a pool of credit card receivables to the proportional method must use the automatic change in method procedures of Rev. Proc. 2019-43, 2019-48 I.R.B. 1107, or its successor, to make the change on a timely filed (including extensions) original Federal income tax return for the year of change. 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 OID on the pool, reduced by any amounts representing charges or fees that are not properly treated as OID (such as credit card late fees, credit card cash advance fees, and interchange fees). See section 4.01 of this revenue procedure. If a taxpayer does not already have a method of accounting for OID 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.

.05 Modification to section 5.02(1) of Rev. Proc. 2013-26. Section 5.02(1) of Rev. Proc. 2013-26 is modified to read as follows:

(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 or specified fees as defined in § 1.451-3(j)).

.06 Modification to section 7 of Rev. Proc. 2013-26. Section 7 of Rev. Proc. 2013-26 is modified by adding a second sentence to read as follows: The modifications to this revenue procedure by Rev. Proc. 2021-35 are effective on August 12, 2021.

.07 Modification to section 8 of Rev. Proc. 2013-26. Section 8 of Rev. Proc. 2013-26 is modified to read as follows:

SECTION 8. AUTOMATIC CHANGE PROCEDURES

Section 30.02 of Rev. Proc. 2019-43, as modified by Rev. Proc. 2021-34, 2021-35 I.R.B. ___, provides procedures for a taxpayer to obtain the automatic consent of the Commissioner to change the taxpayer's method of accounting for OID on a pool of credit card receivables to the proportional method described in this revenue procedure.

SECTION 4. EFFECTIVE DATE

The modifications to Rev. Proc. 2013-26 in section 3 of this revenue procedure are effective on August 12, 2021.

SECTION 5. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies Rev. Proc. 2013-26.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Deepan Patel of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Mr. Patel on (202) 317-3423 (not a toll-free call).