



Department  
of the  
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Internal  
Revenue  
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# List of Original Issue Discount Instruments

For use in preparing  
**2001** Returns



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## Important Change

**Decrease in backup withholding rate.** For payments after August 6, 2001, that are subject to backup withholding, the rate at which tax must be withheld decreased from 31% to 30.5%. For payments made in 2002, the backup withholding rate has further decreased to 30%. See *Backup Withholding under Information for Brokers and Other Middlemen*.

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## Important Reminder

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

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## Introduction

This publication has two purposes. Its primary purpose is to help brokers and other middlemen identify publicly offered original issue discount (OID) debt instruments they may hold as nominees for the true owners, so they can file Forms 1099-OID or Forms 1099-INT as required. The other purpose of the publication is to help owners of publicly offered OID debt instruments determine how much OID to report on their income tax returns.

This publication contains a list of publicly offered OID debt instruments. The information on this list comes from the issuers of the debt instruments and from financial publications and is updated annually. (However, see *Debt Instruments Not on the OID List*, later.)

Brokers and other middlemen can rely on this list to determine, for information reporting purposes, whether a debt instrument was issued at a discount and the OID to be reported on information returns. However, because the information in the list has generally not been verified by the IRS as correct, the following tax matters are subject to change upon examination by the IRS.

- The OID reported by owners of a debt instrument on their income tax returns.
- The issuer's classification of an instrument as debt for federal income tax purposes.

**Instructions for issuers of OID debt instruments.** In general, issuers of publicly offered OID debt instruments must, within 30 days after the issue date, report information about the instruments to the IRS on Form 8281, *Information Return for Publicly Offered Original Issue Discount Instruments*. See the form instructions for more information.



Issuers should report errors in and omissions from the list in writing at the following address:

OID Publication Project  
W:CAR:MP:FP:P Room 5607  
Internal Revenue Service  
1111 Constitution Ave. NW  
Washington, D.C. 20224

**REMIC and CDO information reporting requirements.** Brokers and other middlemen must follow special information reporting requirements for real estate mortgage investment (REMIC) regular and collateralized debt obligations (CDO) interests. The rules are explained in Publication 938, *Real Estate Mortgage Investment Conduits (REMICs) Reporting Information*.

Holders of interests in REMICs and CDOs should see chapter 1 of Publication 550 for information on REMICs and CDOs.

**Comments and suggestions.** We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at [www.irs.gov](http://www.irs.gov).

You can write to us at the following address:

Internal Revenue Service  
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We respond to many letters by telephone. It would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

### Useful Items

You may want to see:

#### Publication

- 515** Withholding of Tax on Nonresident Aliens and Foreign Entities
- 550** Investment Income and Expenses
- 938** Real Estate Mortgage Investment Conduits (REMICs) Reporting Information

#### Form (and Instructions)

- Schedule B (Form 1040)** Interest and Ordinary Dividends
- Schedule D (Form 1040)** Capital Gains and Losses
- 1096** Annual Summary and Transmittal of U.S. Information Returns
- 1099-B** Proceeds From Broker and Barter Exchange Transactions
- 1099-INT** Interest Income
- 1099-OID** Original Issue Discount

See *How To Get Tax Help* near the end of the text for information about getting publications and forms.

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## Definitions

The following terms are used throughout this publication. "Original issue discount" is defined first. The other terms are listed alphabetically.

**Original issue discount (OID).** OID is a form of interest. It is the excess of a debt instrument's stated redemption price at maturity over its issue price (acquisition price for a stripped bond or coupon). Zero coupon bonds and debt instruments that pay no stated interest until maturity are examples of debt instruments that have OID.

**Accrual period.** An accrual period is an interval of time used to measure OID. The length of an accrual period can be 6 months, a year, or some other period, depending on when the debt instrument was issued.

**Acquisition premium.** Acquisition premium is the excess of a bond's adjusted basis immediately after purchase, including purchase at original issue, over the bond's adjusted issue price at that time. A bond does not have acquisition premium, however, if the bond was purchased at a premium. See *Premium*, later.

**Adjusted issue price.** The adjusted issue price of a debt instrument at the beginning of an accrual period is used to figure the OID allocable to that period. In general, the adjusted issue price at the beginning of the instrument's first accrual period is its issue price. The adjusted issue price at the beginning of any subsequent accrual period is the sum of the issue price and all the OID includible in income before that accrual period minus any payment previously made on the instrument, other than a payment of qualified stated interest.

**Debt instrument.** The term "debt instrument" means a bond, debenture, note, certificate, or other evidence of indebtedness. It generally does not include an annuity contract.

**Issue price.** For instruments listed in *Section I-A* and *Section I-B*, the issue price is the initial offering price to the public (excluding bond houses and brokers) at which a substantial amount of these instruments was sold.

**Market discount.** Market discount arises when a debt instrument purchased in the secondary market has decreased in value since its issue date, generally because of an increase in interest rates. An OID bond has market discount if your adjusted basis in the bond immediately after you acquired it (usually its purchase price) was less than the bond's issue price plus the total OID that accrued before you acquired it. The market discount is the difference between the issue price plus accrued OID and your adjusted basis.

**Premium.** A debt instrument is purchased at a premium if its adjusted basis immediately after purchase is greater than the total of all amounts payable on the instrument after the purchase date, other than qualified stated interest. The premium is the excess of the adjusted basis over the payable amounts. See Publication 550 for information on the tax treatment of bond premium.

**Qualified stated interest.** In general, qualified stated interest is stated interest that is unconditionally payable in cash or property (other

than debt instruments of the issuer) at least annually over the term of the instrument at a single fixed rate.

**Stated redemption price at maturity.** An instrument's stated redemption price at maturity is the sum of all amounts (principal and interest) payable on the instrument other than qualified stated interest.

**Yield to maturity (YTM).** In general, the YTM is the discount rate that, when used in figuring the present value of all principal and interest payments, produces an amount equal to the issue price of the bond. The YTM is generally shown on the face of the bond or in the literature you receive from your broker. If you do not have this information, consult your broker, tax advisor, or the issuer.

## Information in the OID List

The information in the OID list can be used by brokers and other middlemen to prepare information returns for 2001.



*If you own a listed debt instrument, you generally should not rely on the information in the OID list to determine (or compare) the OID to be reported on your tax return. The OID amounts listed are figured without reference to the price or date at which you acquired the debt instrument. For information about determining the OID to be reported on your tax return, see the instructions for figuring OID under Information for Owners of OID Debt Instruments, later.*

The following discussions explain what information is contained in each section of the list.

**Section I.** This section contains publicly offered, long-term debt instruments. *Section I-A* lists corporate debt instruments issued before 1985. *Section I-B* lists debt instruments issued after 1984.



*When this publication was being prepared for print, the OID on inflation-indexed instruments for 2001 was not available. Section I-C, Inflation-Indexed Debt Instruments, is not included in this publication. See Publication 553, Highlights of 2001 Tax Changes, for the OID on inflation-indexed instruments for 2001.*

For each publicly offered debt instrument in *Section I*, the list contains the following information.

- The name of the issuer.
- The Committee on Uniform Security Identification Procedures (CUSIP) number.
- The issue date.
- The maturity date.
- The issue price expressed as a percent of principal or of stated redemption price at maturity.
- The annual stated or coupon interest rate. (This rate is shown as 0.00 if no annual interest payments are provided.)

- The total OID up to January 1, 2001. (This information is not available for every instrument.)
- For long-term instruments issued after July 1, 1982, the daily OID for the accrual periods falling in calendar years 2001 and 2002.
- The total OID per \$1,000 of principal or maturity value for calendar years 2001 and 2002.

See *Table 1* on the page preceding *Section I-A* for an explanation of these items.

**Section II.** This section contains stripped obligations available through the Department of the Treasury's Separate Trading of Registered Interest and Principal of Securities (STRIPS) program and government-sponsored enterprises such as the Resolution Funding Corporation. This section also includes instruments backed by U.S. Treasury securities that represent ownership interests in those securities.

The obligations listed in *Section II* are arranged by maturity date. The amounts listed are the total OID for calendar year 2001 per \$1,000 of redemption price.

**Section III.** This section contains short-term discount obligations. *Section III-A* lists Treasury bills (T-bills), which are short-term discount obligations issued by the U.S. Treasury Department. *Sections III-B* through *III-G* contain short-term discount obligations issued by the Student Loan Marketing Association, Federal Home Loan Banks, the Federal National Mortgage Association, Federal Farm Credit Banks, the Federal Home Loan Mortgage Corporation, and the Federal Agricultural Mortgage Corporation.



Information that supplements *Section III-A* is available on the Internet at [www.publicdebt.treas.gov](http://www.publicdebt.treas.gov).

The short-term obligations listed in this section are arranged by maturity date. For each obligation, the list contains the CUSIP number, maturity date, issue date, issue price (expressed as a percent of principal), and discount to be reported as interest for calendar year 2001 per \$1,000 of redemption price. Brokers and other middlemen should rely on the issue price information in *Section III* only if they are unable to determine the price actually paid by the owner.

## Debt Instruments Not on the OID List

The list of debt instruments in this publication does not contain the following items.

- U.S. savings bonds.
- Certificates of deposit and other face-amount certificates issued at a discount, including syndicated certificates of deposit.
- Obligations issued by tax-exempt organizations.

- OID debt instruments that matured or were entirely called by the issuer before 2001.
- Mortgage-backed securities and mortgage participation certificates.
- Long-term OID debt instruments issued before May 28, 1969.
- Short-term obligations, other than the obligations listed in *Section III*.
- Original issue U.S. Treasury notes and bonds. These debt instruments are direct obligations of the U.S. Government. Generally, they contain either de minimis or no discount at original issue. See *U.S. Treasury Bills, Notes, and Bonds* in chapter 1 of Publication 550 for more information.
- Debt instruments issued at a discount by states or their political subdivisions.
- REMIC regular interests and CDOs.
- Commercial paper and banker's acceptances issued at a discount.
- Obligations issued at a discount by individuals.
- Foreign obligations not traded in the United States and obligations not issued in the United States.
- OID debt instruments for which no information was available or that were issued in late 2001 after publication of this list. These will be included in the next revision of the publication.

## Information for Brokers and Other Middlemen

The following discussions contain specific instructions for brokers and middlemen who hold or redeem a debt instrument for the owner.

In general, you must file a Form 1099 for the debt instrument if the interest or OID to be included in the owner's income for 2001 totals \$10 or more. You also must file a Form 1099 if you were required to deduct and withhold tax, even if the interest or OID is less than \$10. See *Backup Withholding*, later.

If you must file a Form 1099, furnish a copy to the owner of the debt instrument by January 31, 2002. By February 28, 2002, (April 1, 2002, if you file electronically), file all your Forms 1099 with the IRS, accompanied by Form 1096.

For more information, including penalties for failure to file (or furnish) required information returns or statements, see the *2001 General Instructions for Form 1099, 1098, 5498, and W-2G*.

## Short-Term Obligations Redeemed at Maturity

If you redeem a short-term discount obligation for the owner at maturity, you must report the discount as interest on Form 1099-INT.

To figure the discount, use the purchase price shown on the owner's copy of the

purchase confirmation receipt or similar record, or the price shown in your transaction records.



If you sell the obligation for the owner before maturity, you must file Form 1099-B to reflect the gross proceeds to the seller. Do **not** report the accrued discount to the date of sale on either Form 1099-INT or Form 1099-OID.

If the owner's purchase price **cannot** be determined, figure the discount as if the owner had purchased the obligation at its original issue price. A special rule is used to determine the original issue price for information reporting on U.S. Treasury bills (T-bills) listed in Section III-A. Under this rule, you treat as the original issue price of the T-bill the noncompetitive (weighted average of accepted auction bids) discount price for the longest-maturity T-bill maturing on the same date as the T-bill being redeemed. This noncompetitive discount price is the issue price (expressed as a percent of principal) shown in Section III-A.

A similar rule is used to figure the discount on short-term discount obligations issued by the organizations listed in Section III-B through Section III-G.

**Example 1.** There are 13-week and 26-week T-bills maturing on the same date as the T-bill being redeemed. The price actually paid by the owner cannot be established by owner or middleman records. You treat as the issue price of the T-bill the noncompetitive discount price (expressed as a percent of principal) shown in Section III-A for a 26-week bill maturing on the same date as the T-bill redeemed. The interest you report on Form 1099-INT is the discount (per \$1,000 of principal) shown in Section III-A for that obligation.

## Long-Term Debt Instruments

If you hold a long-term OID debt instrument as a nominee for the true owner, you generally must file Form 1099-OID. For this purpose, you can rely on Section I of the OID list to determine the following information.

- Whether an instrument has OID.
- The OID to be reported on the Form 1099-OID.

In general, you must report OID on publicly offered, long-term debt instruments listed in Section I. You also may report OID on other long-term debt instruments.

**Form 1099-OID.** On Form 1099-OID for 2001, show the following information.

- **Box 1.** The OID for the actual dates the owner held the instruments during 2001. To determine this amount, see *Figuring OID*, next.
- **Box 2.** The qualified stated interest paid or credited during the calendar year. Interest reported here is not reported on Form 1099-INT. The qualified stated interest on Treasury inflation-indexed securities may be reported in box 3 of Form 1099-INT instead.

- **Box 3.** Any interest or principal forfeited because of an early withdrawal that the owner can deduct from gross income. Do **not** reduce the amounts in boxes 1 and 2 by the forfeiture.
- **Box 4.** Any backup withholding for this instrument.
- **Box 5.** The CUSIP number, if any. If there is no CUSIP number, give a description of the instrument, including the abbreviation for the stock exchange, the abbreviation used by the stock exchange for the issuer, the coupon rate, and the year of maturity (for example, NYSE XYZ 12.50 2002). If the issuer of the instrument is other than the payer, show the name of the issuer in this box.
- **Box 6.** The OID on a U.S. Treasury obligation for the part of the year the owner held the instrument.

**Figuring OID.** You can determine the OID on a long-term debt instrument by using either of the following.

- Section I of the OID list.
- The income tax regulations.

**Using Section I.** If the owner held the debt instrument for the entire calendar year, report the OID shown in Section I for the calendar year. Because OID is listed for each \$1,000 of stated redemption price at maturity, you must adjust the listed amount to reflect the instrument's actual stated redemption price at maturity. For example, if the instrument's stated redemption price at maturity is \$500, report one-half the listed OID.

If the owner held the debt instrument for less than the entire calendar year, figure the OID to report as follows.

- 1) Look up the daily OID for the first 2001 accrual period during which the owner held the instrument.
- 2) Multiply the daily OID by the number of days in 2001 the owner held the instrument during that accrual period.
- 3) Repeat steps (1) and (2) for any remaining 2001 accrual periods during which the owner held the instrument.
- 4) Add the results in steps (2) and (3) to determine the owner's OID per \$1,000 of stated redemption price at maturity.
- 5) If necessary, adjust the OID in (4) to reflect the instrument's stated redemption price at maturity.

Report the result in box 1 of Form 1099-OID.

**Using the income tax regulations.** Instead of using Section I to figure OID, you can use the regulations under sections 1272 through 1275 of the Internal Revenue Code. For example, under the regulations, you can use monthly accrual periods in figuring OID for a debt instrument issued after April 3, 1994, that provides for monthly payments. (If you use Section I-B, the OID is figured using 6-month accrual periods.)

For a general explanation of the rules for figuring OID under the regulations, see *Figuring OID on Long-Term Debt Instruments* under *In-*

*formation for Owners of OID Debt Instruments*, later.

## Certificates of Deposit

If you hold a bank certificate of deposit (CD) as a nominee, you must determine whether the CD has OID and any OID includible in the income of the owner. You must file an information return showing the reportable interest and OID, if any, on the CD. These rules apply whether or not you sold the CD to the owner. Report OID on a CD in the same way as OID on other debt instruments. See *Short-Term Obligations Redeemed at Maturity* and *Long-Term Debt Instruments*, earlier.

## Bearer Bonds and Coupons

If a coupon from a bearer bond is presented to you for collection before the bond matures, you generally must report the interest on Form 1099-INT. However, do **not** report the interest if either of the following apply.

- You hold the bond as a nominee for the true owner.
- The payee is a foreign person. See *Payments to a foreign person under Backup Withholding*, later.

Because you cannot assume the presenter of the coupon also owns the bond, you should **not** report OID on the bond on Form 1099-OID. The coupon may have been "stripped" (separated) from the bond and separately purchased.

However, if a long-term bearer bond on the OID list in this publication is presented to you for redemption upon call or maturity, you should prepare a Form 1099-OID showing the OID for that calendar year, as well as any coupon interest payments collected at the time of redemption.

## Backup Withholding

If you report OID on Form 1099-OID or interest on Form 1099-INT for 2002, you may be required to apply backup withholding to the reportable payment at a rate of 30%. (For 2001, the rate was 30.5% for payments after August 6 and 31% for earlier payments.) The backup withholding tax is deducted at the time a cash payment is made.

Backup withholding generally applies in the following situations.

- 1) The payee does not give you a taxpayer identification number (TIN).
- 2) The IRS notifies you that the payee gave an incorrect TIN.
- 3) The IRS notifies you that the payee is subject to backup withholding due to payee underreporting.
- 4) For debt instruments acquired after 1983:
  - a) The payee does not certify, under penalties of perjury, that he or she is not subject to backup withholding under (3).
  - b) The payee does not certify, under penalties of perjury, that the TIN given is correct.

However, for short-term discount obligations (other than government obligations), bearer bond coupons, and U.S. savings bonds, backup withholding applies only if the payee does not give you a TIN or gives you an obviously incorrect number for a TIN.

**Short-term obligations.** Backup withholding applies to OID on a short-term obligation only when the OID is paid at maturity. However, backup withholding applies to any interest payable before maturity when the interest is paid or credited.

If the owner of a short-term obligation at maturity is not the original owner and can establish the purchase price of the obligation, the amount subject to backup withholding must be determined by treating the purchase price as the issue price. However, you can choose to disregard that price if it would require significant manual intervention in the computer or recordkeeping system used for the obligation. If the purchase price of a listed obligation is not established or is disregarded, you must use the issue price shown in *Section III*.

**Long-term obligations.** If no cash payments are made on a long-term obligation before maturity, backup withholding applies only at maturity. The amount subject to backup withholding is the OID includible in the owner's gross income for the calendar year when the obligation matures. The amount to be withheld is limited to the cash paid.

**Registered long-term obligations with cash payments.** If a registered long-term obligation has cash payments before maturity, backup withholding applies when a cash payment is made. The amount subject to backup withholding is the total of the qualified stated interest (defined earlier under *Definitions*) and OID includible in the owner's gross income for the calendar year when the payment is made. If more than one cash payment is made during the year, the OID subject to withholding for the year must be allocated among the expected cash payments in the ratio that each bears to the total of the expected cash payments. For any payment, the required withholding is limited to the cash paid.

**Payee not the original owner.** If the payee is not the original owner of the obligation, the OID subject to backup withholding is the OID includible in the gross income of all owners during the calendar year (without regard to any amount paid by the new owner at the time of transfer). The amount subject to backup withholding at maturity of a listed obligation must be determined using the issue price shown in *Section I*.

**Bearer long-term obligations with cash payments.** If a bearer long-term obligation has cash payments before maturity, backup withholding applies when the cash payments are made. For payments before maturity, the amount subject to withholding is the qualified stated interest (defined earlier under *Definitions*) includible in the owner's gross income for the calendar year. For a payment at maturity, the amount subject to withholding is only the total of any qualified stated interest paid at maturity and the OID includible in the owner's gross income for the calendar year when the obligation ma-

tures. The required withholding at maturity is limited to the cash paid.

**Sales and redemptions.** If you report the gross proceeds from a sale, exchange, or redemption of a debt instrument on Form 1099-B for 2002, you may be required to withhold 30% of the amount reported. (For 2001, the backup withholding rate was 30.5% for payments after August 6 and 31% for earlier payments.) Backup withholding applies in the following situations.

- The payee does not give you a TIN.
- The IRS notifies you that the payee gave an incorrect TIN.
- For debt instruments held in an account opened after 1983, the payee does not certify, under penalties of perjury, that the TIN given is correct.

**Payments outside the United States to U.S. person.** The requirements for backup withholding and information reporting apply to payments of OID and interest made outside the United States to a U.S. person, a controlled foreign corporation, or a foreign person at least 50% of whose income for the preceding 3-year period is effectively connected with the conduct of a U.S. trade or business.

**Payments to foreign person.** The following discussions explain the rules for backup withholding and information reporting on payments to foreign persons.

**U.S.-source amount.** Backup withholding and information reporting are not required for payments of U.S.-source OID, interest, or proceeds from a sale or redemption of an OID instrument if the payee has given you proof (generally the appropriate Form W-8 or an acceptable substitute) that the payee is a foreign person. A U.S. resident is not a foreign person. For proof of the payee's foreign status, you can rely on the appropriate Form W-8 or on documentary evidence for payments made outside the United States to an offshore account or, in case of broker proceeds, a sale effected outside the United States. Receipt of the appropriate Form W-8 does not relieve you from information reporting and backup withholding if you actually know the payee is a U.S. person.

For information about the 30% withholding tax that may apply to payments of U.S.-source OID or interest to foreign persons, see Publication 515.

**Foreign-source amount.** Backup withholding and information reporting are not required for payments of foreign-source OID and interest made outside the United States. However, if the payments are made inside the United States, the requirements for backup withholding and information reporting will apply unless the payee has given you the appropriate Form W-8 or acceptable substitute as proof that the payee is a foreign person.

**More information.** See sections 1.6049-5 of the regulations for more information about backup withholding and information reporting on foreign-source amounts or payments to foreign persons.

## Information for Owners of OID Debt Instruments

This section is for persons who prepare their own tax returns. It discusses the income tax rules for figuring and reporting OID on long-term debt instruments. It also includes a similar discussion for stripped bonds and coupons, such as zero coupon instruments available through the Department of the Treasury's STRIPS program and government-sponsored enterprises such as the Resolution Funding Corporation. However, the information provided does not cover every situation. More information can be found in the regulations under sections 1271 through 1275 of the Internal Revenue Code.

**Reporting OID.** Generally, you report OID as it accrues each year, whether or not you receive any payments from the bond issuer.

**Exceptions.** The rules for reporting OID on long-term instruments do not apply to the following debt instruments.

- U.S. savings bonds.
- Tax-exempt obligations. (However, see *Tax-Exempt Bonds and Coupons*, later.)
- Obligations issued by individuals before March 2, 1984.
- Loans of \$10,000 or less between individuals who are not in the business of lending money. (The dollar limit includes outstanding prior loans by the lender to the borrower.) This exception does not apply if a principal purpose of the loan is to avoid any federal tax.

See chapter 1 of Publication 550 for information about the rules for these and other types of discounted instruments, such as short-term and market discount obligations. Publication 550 also discusses rules for holders of REMIC interests and CDOs.

**De minimis rule.** You can treat OID as zero if the total OID on a debt instrument is less than one-fourth of 1% (.0025) of the stated redemption price at maturity multiplied by the number of full years from the date of original issue to maturity. Long-term instruments with de minimis OID are not listed in this publication.

**Example 2.** You bought at issuance a 10-year bond with a stated redemption price at maturity of \$1,000, issued at \$980 with OID of \$20. One-fourth of 1% of \$1,000 (the stated redemption price) times 10 (the number of full years from the date of original issue to maturity) equals \$25. Under the de minimis rule, you can treat the OID as zero because the \$20 discount is less than \$25.

**Example 3.** Assume the same facts as *Example 2*, except the bond was issued at \$950. You must report part of the \$50 OID each year because it is more than \$25.

**Choice to report all interest as OID.** Generally, you can choose to treat all interest on a debt instrument acquired after April 3, 1994, as OID and include it in gross income by using the

constant yield method. See *Figuring OID using the constant yield method under Debt Instruments Issued After 1984*, later, for more information.

For this choice, interest includes stated interest, acquisition discount, OID, de minimis OID, market discount, de minimis market discount, and unstated interest, as adjusted by any amortizable bond premium or acquisition premium. See section 1.1272-3 of the regulations for more information.

**Purchase after date of original issue.** A debt instrument you purchased after the date of original issue may have premium, acquisition premium, or market discount. If so, the OID reported to you on Form 1099-OID may have to be adjusted. For more information, see *Showing an OID adjustment under How To Report OID*, later.

**Adjustment for premium.** If your debt instrument (other than a contingent payment debt instrument or an inflation-indexed debt instrument) has premium, do not report any OID as ordinary income. Your adjustment is the total OID shown on your Form 1099-OID.

**Adjustment for acquisition premium.** If your debt instrument has acquisition premium, reduce the OID you report. Your adjustment is the difference between the OID shown on your Form 1099-OID and the reduced OID amount figured using the rules explained later under *Figuring OID on Long-Term Debt Instruments*.

**Adjustment for market discount.** If your debt instrument has market discount that you choose to include in income currently, increase the OID you report. Your adjustment is the accrued market discount for the year.

See *Market Discount Bonds* in chapter 1 of Publication 550 for information on how to figure accrued market discount and include it in your income currently and for other information about market discount bonds. If you choose to use the constant yield method to figure accrued market discount, also see *Figuring OID on Long-Term Debt Instruments*, later. The constant yield method of figuring accrued OID, explained in those discussions under *Figuring OID using the constant yield method*, is also used to figure accrued market discount.

**Sale, exchange, or redemption.** Generally, you treat your gain or loss from the sale, exchange, or redemption of a discounted bond or other debt instrument as a capital gain or loss if you held the bond as a capital asset. If you sold the bond through a broker, you should receive Form 1099-B or an equivalent statement from the broker. Use the Form 1099-B or other statement and your brokerage statements to complete Schedule D (Form 1040).

Your gain or loss is the difference between the amount you realized on the sale, exchange, or redemption and your basis in the debt instrument. Your basis, generally, is your cost increased by the OID you have included in income each year you held it. To determine your gain or loss on a tax-exempt bond, figure your basis in the bond by adding to your cost the OID you would have included in income if the bond had been taxable.

See chapter 4 of Publication 550 for more information about the tax treatment of the sale or redemption of discounted debt instruments.

**Example 4.** On November 1, 1998, Larry, a calendar year taxpayer, bought a corporate bond at original issue for \$86,235.17. The 15-year bond matures on October 31, 2013, at a stated redemption price of \$100,000. The bond provides for semiannual payments of interest at 10%. Assume the bond is a capital asset in Larry's hands. The bond has \$13,764.83 of OID (\$100,000 stated redemption price at maturity minus \$86,235.17 issue price).

On November 1, 2001, Larry sold the bond for \$90,000. Including the OID he will report for the period he held the bond in 2001, Larry has included \$1,214.48 of OID in income and has increased his basis by that amount to \$87,449.65. Larry has realized a gain of \$2,550.35. All of Larry's gain is capital gain.

## Form 1099-OID

The issuer of the debt instrument (or your broker, if you purchased or held the instrument through a broker) should give you a copy of Form 1099-OID or a similar statement if the accrued OID for the calendar year is \$10 or more and the term of the instrument is more than 1 year. Form 1099-OID shows all OID income in box 1 except OID on a U.S. Treasury obligation, which is shown in box 6. It also shows, in box 2, any qualified stated interest you must include in income. (However, any qualified stated interest on Treasury inflation-indexed securities that is not OID can be reported in box 3 of Form 1099-INT.) A copy of Form 1099-OID will be sent to the IRS. Do not attach your copy to your tax return. Keep it for your records.



*If you are required to file a tax return and you receive Form 1099-OID showing taxable amounts, you must report these amounts on your return. A 20% accuracy-related penalty may be charged for underpayment of tax due to either of the following reasons.*

- Negligence or disregard of rules and regulations.
- Substantial understatement of tax.

**Form 1099-OID not received.** If you held an OID instrument for 2001 but did not receive a Form 1099-OID, refer to the later discussions under *Figuring OID on Long-Term Debt Instruments* for information on the OID you must report.

**Refiguring OID.** You must refigure the OID shown in box 1 or box 6 of Form 1099-OID to determine the proper amount to include in income if one of the following applies.

- You bought the debt instrument at a premium or at an acquisition premium.
- The debt instrument is a stripped bond or coupon (including zero coupon instruments backed by U.S. Treasury securities).
- The debt instrument is a contingent payment or inflation-indexed debt instrument.

See the discussions under *Figuring OID on Long-Term Debt Instruments* or *Figuring OID on Stripped Bonds and Coupons*, later, for the specific computations

**Refiguring interest.** If you disposed of a debt instrument or acquired it from another holder between interest dates, see the discussion under *Bonds Sold Between Interest Dates* in chapter 1 of Publication 550 for information about refiguring the interest shown in box 2 of Form 1099-OID.

**Nominee.** If you are the holder of an OID instrument and you receive a Form 1099-OID that shows your taxpayer identification number and includes amounts belonging to another person, you are considered a "nominee." You must file another Form 1099-OID for each actual owner, showing the OID for the owner. Show the owner of the instrument as the "recipient" and you as the "payer."

Complete Form 1099-OID and Form 1096 and file the forms with the Internal Revenue Service Center for your area. You must also give a copy of the Form 1099-OID to the actual owner. However, you are not required to file a nominee return to show amounts belonging to your spouse. See the Form 1099 instructions for more information.

When preparing your tax return, follow the instructions under *Showing an OID adjustment* in the next discussion.

## How To Report OID

Generally, you report your taxable interest and OID income on line 2, Form 1040EZ; line 8a, Form 1040A; or line 8a, Form 1040.

**Form 1040 or Form 1040A required.** You must use Form 1040 or Form 1040A (you cannot use Form 1040EZ) under either of the following conditions.

- You received a Form 1099-OID as a nominee for the actual owner.
- Your total interest and OID income for the year was more than \$400.

You must use Form 1040 (you cannot use Form 1040A or Form 1040EZ) if you are reporting more or less OID than the amount shown on Form 1099-OID, other than because you are a nominee. For example, if you paid a premium or an acquisition premium when you purchased the debt instrument, you must use Form 1040 because you will report less OID than shown on Form 1099-OID. Also, you must use Form 1040 if you were charged an early withdrawal penalty.

**Where to report.** List each payer's name (if a brokerage firm gave you a Form 1099, list the brokerage firm as the payer) and the amount received from each payer on line 1 of Schedule 1 (Form 1040A) or line 1 of Schedule B (Form 1040). Include all OID and periodic interest shown in boxes 1, 2, and 6 of any Form 1099-OID you received for the tax year. Also include any other OID and interest income for which you did not receive a Form 1099.

**Showing an OID adjustment.** If you use Form 1040 to report more or less OID than shown on Form 1099-OID, list the full OID on line 1, Part I of Schedule B and follow the instructions under (1) or (2), next.

If you use Form 1040A to report the OID shown on a Form 1099-OID you received as a nominee for the actual owner, list the full OID on line 1, Part I of Schedule 1 and follow the instructions under (1).

- 1) If the OID, as adjusted, is less than the amount shown on Form 1099–OID, show the adjustment as follows.
  - a) Under your last entry on line 1, subtotal all interest and OID income listed on line 1.
  - b) Below the subtotal, write “Nominee Distribution” or “OID Adjustment” and show the OID you are not required to report.
  - c) Subtract that OID from the subtotal and enter the result on line 2.
- 2) If the OID, as adjusted, is more than the amount shown on Form 1099–OID, show the adjustment as follows.
  - a) Under your last entry on line 1, subtotal all interest and OID income listed on line 1.
  - b) Below the subtotal, write “OID Adjustment” and show the additional OID.
  - c) Add that OID to the subtotal and enter the result on line 2.

## Figuring OID on Long-Term Debt Instruments

How you figure the OID on a long-term debt instrument depends on the date it was issued. It also may depend on the type of the instrument. There are different rules for each of the following debt instruments.

- 1) Corporate debt instruments issued after 1954 and before May 28, 1969, and government instruments issued after 1954 and before July 2, 1982.
- 2) Corporate debt instruments issued after May 27, 1969, and before July 2, 1982.
- 3) Debt instruments issued after July 1, 1982, and before 1985.
- 4) Debt instruments issued after 1984 (other than debt instruments described in (5) and (6)).
- 5) Contingent payment debt instruments issued after August 12, 1996.
- 6) Inflation-indexed debt instruments (including Treasury inflation-indexed securities) issued after January 5, 1997.

**Zero coupon instrument.** The rules for figuring OID on zero coupon instruments backed by U.S. Treasury securities are discussed later under *Figuring OID on Stripped Bonds and Coupons*.

### Corporate Debt Instruments Issued After 1954 and Before May 28, 1969, and Government Instruments Issued After 1954 and Before July 2, 1982

If you hold these debt instruments as capital assets, you include OID in income only in the year the instrument is sold, exchanged, or redeemed, and only if you have a gain. The OID,

which is taxed as ordinary income, generally equals the following amount.

$$\frac{\text{number of full months you held the instrument}}{\text{number of full months from date of original issue to date of maturity}} \times \text{original issue discount}$$

The balance of the gain is capital gain. If there is a loss on the sale of the instrument, the entire loss is a capital loss and no OID is reported.

### Corporate Debt Instruments Issued After May 27, 1969, and Before July 2, 1982

If you hold these debt instruments as capital assets, you must include part of the discount in income each year you own the instruments. For information about showing the correct OID on your tax return, see the discussion under *How To Report OID*, earlier. Your basis in the instrument is increased by the OID you include in income.

**Form 1099–OID.** You should receive a Form 1099–OID showing OID for the part of the year you held the bond. However, if you paid an acquisition premium, you may need to refigure the OID to report on your tax return. See *Reduction for acquisition premium*, later.

**Form 1099–OID not received.** If you held an OID instrument in 2001 but did not receive a Form 1099–OID, refer to *Section I–A* later in this publication. The OID listed is for each \$1,000 of redemption price. You must adjust the listed amount if your debt instrument has a different principal amount. For example, if you have an instrument with a \$500 principal amount, use one-half the listed amount to figure your OID.

If you held the instrument the entire year, use the OID shown in *Section I–A* for calendar year 2001. (If your instrument is not listed in *Section I–A*, consult the issuer for information about the issue price and the OID that accrued for 2001.) If you did not hold the instrument the entire year, figure your OID using the following method.

- 1) Divide the OID shown for 2001 by 12.
- 2) Multiply the result in (1) by the number of complete and partial months (for example, 6½ months) you held the debt instrument in 2001. This is the OID to include in income unless you paid an acquisition premium. The reduction for acquisition premium is discussed next.

**Reduction for acquisition premium.** If you bought the debt instrument at an acquisition premium, figure the OID to include in income as follows.

- 1) Divide the total OID on the instrument by the number of complete months, and any part of a month, from the date of original issue to the maturity date. This is the monthly OID.
- 2) Subtract from your cost the issue price and the accumulated OID from the date of issue to the date of purchase. (If the result is zero or less, stop here. You did not pay an acquisition premium.)

- 3) Divide the amount figured in (2) by the number of complete months, and any part of a month, from the date of your purchase to the maturity date.
- 4) Subtract the amount figured in (3) from the amount figured in (1). This is the OID to include in income for each month you hold the instrument during the year.

**Example 5.** On June 1, 1982, Acme Corporation issued 20-year bonds at 90% of the principal amount. On February 1, 2001, you bought Acme bonds with a \$10,000 principal amount on the open market for \$9,950. The amount you must include in income is figured as follows:

1) Monthly OID (\$1,000 total OID ÷ 240 months) . . . . .	\$4.17
2) Your cost . . . . .	\$9,950.00
Minus: Issue price . . . . .	<u>9,000.00</u>
	\$ 950.00
Minus: Accumulated OID (\$4.17 × 224 months) . . . . .	<u>893.08</u>
Acquisition premium . . . . .	<u>\$ 5.92</u>
3) Acquisition premium divided by number of complete and partial months from date of purchase to maturity date (\$5.92 ÷ 16 months) . . . . .	<u>1.00</u>
4) Line 1 minus line 3 . . . . .	<u>\$3.17</u>

You must include \$34.87 (\$3.17 × 11 months) in income for 2001 because the acquisition premium reduces the ratable monthly portion of OID.

**Example 6.** Assume the same facts as in *Example 5*, except that you bought the bonds for \$9,934.08. In this case, your cost equals the original issue price plus accumulated OID. Therefore, you did not pay an acquisition premium. For 2001, include \$45.87 (\$4.17 × 11 months) of OID in income.

**Example 7.** Assume the same facts as in *Example 5*, except that you bought the bonds for \$9,400. In this case, you must include \$45.87 of OID in your 2001 income. You did not pay an acquisition premium because you bought the bonds for less than the sum of the original issue price plus accumulated OID. The bonds have market discount, which must be reported under the rules explained in chapter 1 of Publication 550.

**Transfers during the month.** If you buy or sell a debt instrument on any day other than the same day of the month as the date of original issue, the ratable monthly portion of OID for the month of sale is divided between the seller and the buyer according to the number of days each held the instrument. Your *holding period* for this purpose begins the day you acquire the instrument and ends the day before you dispose of it.

**Example 8.** Assume the same facts as in *Example 5*, except that you bought the bonds on September 14, 2000, for \$9,915.04 (\$9,000 issue price plus \$915.04 accumulated OID) and sold them on March 14, 2001. You figure the OID to include in your 2000 income as follows:

Amount for September (\$4.17 × 17 days + 30 days) . . . . . \$ 2.36  
 Amount for complete months October through December (\$4.17 × 3 months) . . . . . 12.51  
**Total to include in 2000 income . . . . . \$14.87**

You figure the OID to include in your 2001 income as follows.

Amount for complete months January through February (\$4.17 × 2 months) . . . . . \$ 8.34  
 Amount for March (\$4.17 × 13 days + 31 days) . . . . . 1.75  
**Total to include in 2001 income . . . . . \$10.09**

You increase your basis in the bonds by the OID you include in income. Your basis in the bonds when you sold them is \$9,940 (\$9,915.04 cost + \$14.87 OID for 2000 and \$10.09 OID for 2001).

### Debt Instruments Issued After July 1, 1982, and Before 1985

If you hold these debt instruments as capital assets, you must include part of the OID in income each year you own the instruments and increase your basis by the amount included. For information about showing the correct OID on your tax return, see *How To Report OID*, earlier.

**Form 1099.** You should receive a Form 1099–OID showing OID for the part of the year you held the bond. However, if you paid an acquisition premium, you may need to refigure the OID to report on your tax return. See *Figuring OID using the constant yield method* and the discussions on acquisition premium that follow, later.

**Form 1099–OID not received.** If you held an OID instrument in 2001 but did not receive a Form 1099–OID, refer to *Section I–A* later in this publication. The OID listed is for each \$1,000 of redemption price. You must adjust the listed amount if your debt instrument has a different principal amount. For example, if you have an instrument with a \$500 principal amount, use one-half the listed amount to figure your OID.

If you held the debt instrument the entire year, use the OID shown in *Section I–A* for calendar year 2001. (If your instrument is not listed in *Section I–A*, consult the issuer for information about the issue price, the yield to maturity, and the OID that accrued for 2001.) If you did not hold the debt instrument the entire year, figure your OID using either of the following methods.

#### Method 1.

- 1) Divide the total OID for 2001 by 365.
- 2) Multiply the result in (1) by the number of days you held the debt instrument in 2001.

This computation is an approximation and may result in a slightly higher OID than Method 2.

#### Method 2.

- 1) Look up the daily OID for the first 2001 accrual period you held the instrument. (See *Accrual period under Figuring OID using the constant yield method*, next.)

- 2) Multiply the daily OID by the number of days in 2001 you held the instrument during that accrual period.
- 3) If you held the instrument for part of both 2001 accrual periods, repeat (1) and (2) for the second accrual period.
- 4) Add the results of (2) and (3). This is the OID to include in income for 2001, unless you paid an acquisition premium. (The reduction for acquisition premium is discussed later.)

$$\frac{(\$90,000.00 \times 14.5587\%) - \$13,000}{366 \text{ (leap year)}} = \frac{\$102.83}{366} = \$28096$$

You would have included in income \$.28096 for each day you held the bond during 1984. If you held the bond for all of 1984, you would have included OID of \$102.83 (\$.28096 × 366).

The following table shows the adjusted issue price, daily OID, and OID per accrual period through 2001.

Accrual Period	Year	Adjusted Issue Price	Daily OID	OID for Period
1	1984	\$90,000.00	\$.28096	\$ 102.83
2	1985	90,102.83	.32274	117.80
3	1986	90,220.63	.36973	134.95
4	1987	90,355.58	.42356	154.60
5	1988	90,510.18	.48391	177.11
6	1989	90,687.29	.55586	202.89
7	1990	90,890.18	.63679	232.43
8	1991	91,122.61	.72951	266.27
9	1992	91,388.88	.83342	305.03
10	1993	91,693.91	.95737	349.44
11	1994	92,043.35	1.09677	400.32
12	1995	92,443.67	1.25644	458.60
13	1996	92,902.27	1.43541	525.36
14	1997	93,427.63	1.64890	601.85
15	1998	94,029.48	1.88896	689.47
16	1999	94,718.95	2.16397	789.85
17	2000	95,508.80	2.47224	904.84
18	2001	96,413.64	2.83992	1036.57

The daily OID for the 19th accrual period is figured as follows.

$$\frac{(\$97,450.21 \times 14.5587\%) - \$13,000}{365} = \frac{\$1,187.48}{365} = \$3,25338$$

If you hold the bond for all of 2002, you would include \$1,187.48 in income (\$3.25338 × 365).

**Example 10.** Assume the same facts as in *Example 9*, except that you bought the bond at original issue on May 1, 1983. The daily OID for the first accrual period (May 1, 1983 – April 30, 1984) was \$.28096, as figured in *Example 9*. If you held the bond until the end of 1983, you would have included \$68.84 in income for 1983 (\$.28096 × 245 days). If you continued to hold the bond, you would have included in income, for 1984 through 2000, the following amounts of OID.

Year	First Accrual Period	Second Accrual Period	Total
1984	\$.28096 × 121 days	\$.32274 × 245 days	\$113.07
1985	\$.32274 × 120 days	\$.36973 × 245 days	129.31
1986	\$.36973 × 120 days	\$.42356 × 245 days	148.14
1987	\$.42356 × 120 days	\$.48391 × 245 days	169.39
1988	\$.48391 × 121 days	\$.55586 × 245 days	194.74
1989	\$.55586 × 120 days	\$.63679 × 245 days	222.71
1990	\$.63679 × 120 days	\$.72951 × 245 days	255.14
1991	\$.72951 × 120 days	\$.83342 × 245 days	291.73

**Figuring OID using the constant yield method.** This discussion shows how to figure OID on debt instruments issued after July 1, 1982, and before 1985, using a constant yield method. OID is allocated over the life of the instrument through adjustments to the issue price for each accrual period.

Figure the OID allocable to any accrual period as follows.

- 1) Multiply the adjusted issue price at the beginning of the accrual period by the instrument's yield to maturity.
- 2) Subtract from the result in (1) any qualified stated interest allocable to the accrual period.

**Accrual period.** An accrual period for any OID instrument issued after July 1, 1982, and before 1985 is each 1-year period beginning on the date of the issue of the obligation and each anniversary thereafter, or the shorter period to maturity for the last accrual period. Your tax year will usually include parts of two accrual periods.

**Daily OID.** The OID for any accrual period is allocated equally to each day in the accrual period. You must include in income the sum of the OID amounts for each day you hold the instrument during the year. If your tax year includes parts of two or more accrual periods, you must include the proper daily OID amounts for each accrual period.

**Figuring daily OID.** The daily OID for the *initial accrual period* is figured using the following formula.

$$\frac{(ip \times ytm) - qsi}{p}$$

- ip = issue price
- ytm = yield to maturity
- qsi = qualified stated interest
- p = number of days in accrual period

The daily OID for *subsequent accrual periods* is figured the same way except the adjusted issue price at the beginning of each period is used in the formula instead of the issue price.

**Example 9.** On January 1, 1984, you bought a 20-year, 13% bond for \$90,000 at original issue. The redemption price of the bond is \$100,000. The qualified stated interest is \$13,000 (13% × \$100,000), which is unconditionally payable each year. The bond has a yield to maturity of 14.5587%. The daily OID for the first accrual period is figured as follows.



1992	.....	\$ .83342 × 121 days	\$ .95737 × 245 days	335.40
1993	.....	\$ .95737 × 120 days	\$1.09677 × 245 days	383.59
1994	.....	\$1.09677 × 120 days	\$1.25644 × 245 days	439.44
1995	.....	\$1.25644 × 120 days	\$1.43541 × 245 days	502.45
1996	.....	\$1.43541 × 121 days	\$1.64890 × 245 days	577.66
1997	.....	\$1.64890 × 120 days	\$1.88896 × 245 days	660.67
1998	.....	\$1.88896 × 120 days	\$2.16397 × 245 days	756.85
1999	.....	\$2.16397 × 120 days	\$2.47224 × 245 days	865.38
2000	.....	\$2.47224 × 121 days	\$2.83992 × 245 days	994.92

If you sold the bond on August 30, 2001, you would figure the amount to include in your 2001 income as follows.

First accrual period: \$2.83992 × 120 days (Jan 1 – Apr 30) .....	\$340.79
Second accrual period: \$3.25338 × 121 days (May 1 – Aug 29) .....	<u>393.66</u>
<b>Total to include in 2001 income</b> .....	<b><u>\$734.45</u></b>

However, if you held the bond the entire year of 2001, the total OID to report is \$1,137.87 [\$340.79 + \$797.08 (\$3.25338 × 245 days)].

#### Reduction in acquisition premium on debt instruments purchased before July 19, 1984.

If you bought the debt instrument at an acquisition premium before July 19, 1984, figure the OID includible in income by reducing the daily OID by the daily acquisition premium. Figure the daily acquisition premium by dividing the total acquisition premium by the number of days in the period beginning on your purchase date and ending on the day before the date of maturity.

**Example 11.** Assume the same facts as in Example 10, except that you bought the bond for \$92,000 on May 1, 1984, after its original issue on May 1, 1983. In this case, you paid more for the bond than its \$90,102.83 adjusted issue price (\$90,000 + \$102.83). You paid \$1,897.17 (\$92,000 – \$90,102.83) acquisition premium. The daily OID for the accrual period May 1, 1984, through April 30, 1985, reduced for the acquisition premium, is figured as follows.

1) Daily OID on date of purchase (2nd accrual period) .....	\$32274
2) Acquisition premium .....	\$1,897.17
3) Total days from purchase date to maturity date [(365 × 19 years) + 4 days for leap years]	6,939
4) Line 2 + line 3 .....	<u>\$27341</u>
<b>5) Daily OID reduced for the acquisition premium. Line 1 – line 4</b> .....	<b><u>\$04933</u></b>

The OID you would have included in income for 1984 is \$12.09 (\$04933 × 245 days).

Assuming you still owned the bond in 2001, you would have reduced the total OID for each year (as determined in Example 10) by the allocable portion of the acquisition premium for that year. You would have included the following amounts of OID in income.

Year	OID
1985	..... \$ 29.52
1986	..... 48.35
1987	..... 69.60
1988	..... 94.67
1989	..... 122.92
1990	..... 155.35
1991	..... 191.94
1992	..... 235.33
1993	..... 283.80
1994	..... 339.65
1995	..... 402.66
1996	..... 477.59
1997	..... 560.88
1998	..... 657.06
1999	..... 765.59
2000	..... 894.85

If you held the bond all of 2001, reduce the total OID for that year, \$1,137.87 (as determined in Example 10), by the allocable part of the acquisition premium for 2001, \$99.79 (\$27341 × 365 days). The difference, \$1,038.08, is the total OID to include in income for 2001.

**Example 12.** Assume the same facts as in Example 11, except that you bought the bond for \$90,102.83. In this case, you bought the bond for an amount equal to the original issue price plus accumulated OID. Therefore, you did not pay an acquisition premium. You would have included \$79.07 (\$32274 × 245 days) in income for 1984. For the remaining years, you would have included the amounts figured in Example 10.

**Example 13.** Assume the same facts as in Example 11, except that you bought the bond for \$89,500. You did not pay an acquisition premium because your cost was less than the adjusted issue price. You must include in income each year the amounts of OID figured in Example 12. The bonds have market discount, which must be reported under the rules explained in chapter 1 of Publication 550.

#### Reduction for acquisition premium on debt instruments purchased after July 18, 1984.

If you bought the debt instrument at an acquisition premium after July 18, 1984, figure the OID includible in income by reducing the daily OID by the daily acquisition premium. However, the method of figuring the daily acquisition premium is different from the method described in the preceding discussion. To figure the daily acquisition premium under this method, multiply the daily OID by the following fraction.

- The numerator is the acquisition premium.
- The denominator is the total OID remaining for the instrument after your purchase date.

**Example 14.** Assume the same facts as in Example 9, except that you bought the bond for \$99,000 on August 1, 2001, after its original issue on August 1, 1983. In this case, you paid more for the bond than its \$97,450.21 adjusted issue price (\$90,000 + \$7,450.21 accrued OID). You paid \$1,549.79 (\$99,000 – \$97,450.21) acquisition premium. The daily OID for the accrual period August 1, 2001, to July 31, 2002, reduced for the acquisition premium, is figured as follows:

1) Daily OID on date of purchase (19th accrual period) .....	\$3,25338*
2) Acquisition premium .....	\$1,549.79
3) Total OID remaining after purchase date (\$10,000 – \$7,450.21) .....	2,549.79
4) Line 2 + line 3 .....	<u>0.60781</u>
5) Line 1 × line 4 .....	<u>1.97744</u>
<b>6) Daily OID reduced for the acquisition premium. Line 1 – line 5</b> .....	<b><u>\$1.27594</u></b>

\* As shown in Example 9.

The total OID to include in income for 2001 (August 1 – December 31) is \$195.22 (\$1.27594 × 153 days).

If you hold the bond for all of 2002, multiply the total OID for the year by 1.97744 and subtract the result from the total OID. The reduced amount is the total OID to be included in income for 2002.

**Using Section I–A to figure accumulated OID.** If you bought your corporate debt instrument in 2001 or 2002 and it is listed in Section I–A, you can figure the accumulated OID to the date of purchase by adding the following amounts.

- 1) The amount from the “Total OID to January 1, 2001” column for your debt instrument.
- 2) The OID from January 1, 2001, to the date of purchase, figured as follows.
  - a) Multiply the daily OID for the first accrual period in 2001 by the number of days from January 1 to the date of purchase, or the end of the accrual period if the instrument was purchased in the second or third accrual period.
  - b) Multiply the daily OID for each subsequent accrual period by the number of days in the period to the date of purchase or the end of the accrual period, whichever applies.
  - c) Add the amounts figured in (2a) and (2b).

### Debt Instruments Issued After 1984

If you hold debt instruments issued after 1984, you must report part of the discount in gross income each year that you own the instruments. You must include the OID in gross income whether or not you hold the instrument as a capital asset. Your basis in the instrument is increased by the OID you include in income. For information about showing the correct OID on your tax return, see *How To Report OID*, earlier.

**Form 1099–OID.** You should receive a Form 1099–OID showing OID for the part of 2001 you held the bond. However, if you paid an acquisition premium, you may need to refigure the OID to report on your tax return. See *Figuring OID using the constant yield method and Reduction for acquisition premium*, later.

You may also need to refigure the OID for a contingent payment or inflation-indexed debt in-

strument on which the amount reported on Form 1099–OID is inaccurate. See *Contingent Payment Debt Instruments or Inflation-Indexed Debt Instruments*, later.

**Form 1099–OID not received.** If you held an OID instrument in 2001 but did not receive a Form 1099–OID, refer to *Section I–B* later in this publication. The OID listed is for each \$1,000 of redemption price. You must adjust the listed amount if your debt instrument has a different principal amount. For example, if you have an instrument with a \$500 principal amount, use one-half the listed amount to figure your OID.

Use the OID shown in *Section I–B* for the calendar year if you held the instrument the entire year. (If your instrument is not listed in *Section I–B*, consult the issuer for information about the issue price, the yield to maturity, and the OID that accrued for 2001.) If you did not hold the debt instrument the entire year, figure your OID as follows.

- 1) Look up the daily OID for the first 2001 accrual period in which you held the instrument. (See *Accrual period* under *Figuring OID using the constant yield method*, later.)
- 2) Multiply the daily OID by the number of days in 2001 you held the instrument during that accrual period.
- 3) Repeat (1) and (2) for any remaining 2001 accrual periods in which you held the instrument.
- 4) Add the results of (2) and (3). This is the OID to include in income for 2001, unless you paid an acquisition premium. (The reduction for acquisition premium is discussed later.)

**Tax-exempt bond.** If you own a tax-exempt bond, figure your basis in the bond by adding to your cost the OID you would have included in income if the bond had been taxable. You need to make this adjustment to determine if you have a gain or loss on a later disposition of the bond. Use the rules that follow to determine your OID.

**Figuring OID using the constant yield method.** This discussion shows how to figure OID on debt instruments issued after 1984 using a constant yield method. (The special rules that apply to contingent payment debt instruments and inflation-indexed debt instruments are explained later.) OID is allocated over the life of the instrument through adjustments to the issue price for each accrual period.

Figure the OID allocable to any accrual period as follows.

- 1) Multiply the adjusted issue price at the beginning of the accrual period by a fraction. The numerator of the fraction is the instrument's yield to maturity and the denominator is the number of accrual periods per year. The yield must be stated appropriately taking into account the length of the particular accrual period.
- 2) Subtract from the result in (1) any qualified stated interest allocable to the accrual period.

**Accrual period.** For debt instruments issued after 1984 and **before April 4, 1994**, an accrual period is each 6-month period that ends on the day that corresponds to the stated maturity date of the debt instrument or the date 6 months before that date. For example, a debt instrument maturing on March 31 has accrual periods that end on September 30 and March 31 of each calendar year. Any short period is included as the first accrual period.

For debt instruments issued **after April 3, 1994**, accrual periods may be of any length and may vary in length over the term of the instrument, as long as each accrual period is no longer than 1 year and all payments are made on the first or last day of an accrual period. However, the OID listed for these debt instruments in *Section I–B* has been figured using 6-month accrual periods.

**Daily OID.** The OID for any accrual period is allocated equally to each day in the accrual period. Figure the amount to include in income by adding the OID for each day you hold the debt instrument during the year. Since your tax year will usually include parts of two or more accrual periods, you must include the proper daily OID for each accrual period. If your debt instrument has 6-month accrual periods, your tax year will usually include one full 6-month accrual period and parts of two other 6-month periods.

**Figuring daily OID.** The daily OID for the **initial accrual period** is figured using the following formula.

$$\frac{(ip \times ytm/n) - qsi}{p}$$

- ip** = issue price
- ytm** = yield to maturity
- n** = number of accrual periods in 1 year
- qsi** = qualified stated interest
- p** = number of days in accrual period

The daily OID for **subsequent accrual periods** is figured the same way except the adjusted issue price at the beginning of each period is used in the formula instead of the issue price.

**Example 15.** On January 1, 2001, you bought a 15-year, 10% bond of A Corporation at original issue for \$86,235.17. According to the prospectus, the bond matures on December 31, 2015, at a stated redemption price of \$100,000. The yield to maturity is 12%, compounded semi-annually. The bond provides for qualified stated interest payments of \$5,000 on June 30 and December 31 of each calendar year. The accrual periods are the 6-month periods ending on each of these dates. The daily OID for the first accrual period is figured as follows.

$$\frac{(\$86,235.17 \times .12/2) - \$5,000}{181 \text{ days}} = \frac{\$174.11}{181} = \$.96193$$

The adjusted issue price at the beginning of the second accrual period is the issue price plus the OID previously includible in income (\$86,235.17 + \$174.11), or \$86,409.28. The daily OID for the second accrual period is figured as follows.

$$\frac{(\$86,409.28 \times .12/2) - \$5,000}{184 \text{ days}} = \frac{\$184.56}{184} = \$1.00303$$

Since the first and second accrual periods coincide exactly with your tax year, you include in income for 2001 the OID allocable to the first two accrual periods, \$174.11 (\$96193 × 181 days) plus \$184.56 (\$1.00303 × 184 days), or \$358.67. Add the OID to the \$10,000 interest you report in 2001.

**Example 16.** Assume the same facts as in *Example 15*, except that you bought the bond at original issue on May 1, 2001. Also, the interest payment dates are October 31 and April 30 of each calendar year. The accrual periods are the 6-month periods ending on each of these dates.

The daily OID for the first accrual period (May 1, 2001 – October 31, 2001) is figured as follows.

$$\frac{(\$86,235.17 \times .12/2) - \$5,000}{184 \text{ days}} = \frac{\$174.11}{184} = \$.94625$$

The daily OID for the second accrual period (November 1, 2001 – April 30, 2002) is figured as follows.

$$\frac{(\$86,409.28 \times .12/2) - \$5,000}{181 \text{ days}} = \frac{\$184.56}{181} = \$1.01967$$

If you hold the bond through the end of 2001, you must include \$236.31 of OID in income. This is \$174.11 (\$94625 × 184 days) for the period May 1 through October 31 plus \$62.20 (\$1.01967 × 61 days) for the period November 1 through December 31. The OID is added to the \$5,000 interest income paid on October 31, 2001. Your basis in the bond is increased by the OID you include in income. On January 1, 2002, your basis in the A Corporation bond is \$86,471.48 (\$86,235.17 + \$236.31).

**Short first accrual period.** You may have to make adjustments if a debt instrument has a short first accrual period. For example, a debt instrument with 6-month accrual periods that is issued on February 15 and matures on October 31 has a short first accrual period that ends April 30. (The remaining accrual periods begin on May 1 or November 1.) For this short period, figure the daily OID as described earlier, but adjust the yield for the length of the short accrual period. You may use any reasonable compounding method in determining OID for a short period. Examples of reasonable compounding methods include continuous compounding and monthly compounding (that is, simple interest within a month). Consult your tax advisor for more information about making this computation.

The OID for the **final accrual period** is the difference between the amount payable at maturity (other than a payment of qualified stated interest) and the adjusted issue price at the beginning of the final accrual period.

**Reduction for acquisition premium.** If you bought the debt instrument at an acquisition premium, figure the OID includible in income by reducing the daily OID by the daily acquisition premium. To figure the daily acquisition pre-

mium, multiply the daily OID by the following fraction.

- The numerator is the acquisition premium.
- The denominator is the total OID remaining for the instrument after your purchase date.

**Example 17.** Assume the same facts as in Example 16, except that you bought the bond on November 1, 2001, for \$87,000, after its original issue on May 1, 2001. The adjusted issue price on November 1, 2001, is \$86,409.28 (\$86,235.17 + \$174.11). In this case, you paid an acquisition premium of \$590.72 (\$87,000 – \$86,409.28). The daily OID for the accrual period November 1, 2001, through April 30, 2002, reduced for the acquisition premium, is figured as follows.

1) Daily OID on date of purchase (2nd accrual period) . . . . .	\$1.01967*
2) Acquisition premium . . . . .	\$ 590.72
3) Total OID remaining after purchase date (\$13,764.83 – \$174.11) . . . . .	13,590.72
4) Line 2 ÷ line 3 . . . . .	.04346
5) Line 1 × line 4 . . . . .	.04431
6) Daily OID reduced for the acquisition premium. Line 1 – line 5 . . . . .	<u>\$0.97536</u>

\* As shown in Example 16.

The total OID to include in income for 2001 is \$59.50 (\$0.97536 × 61 days).

## Contingent Payment Debt Instruments

This discussion shows how to figure OID on a contingent payment debt instrument issued after August 12, 1996, that was issued for cash or publicly traded property. In general, a **contingent payment debt instrument** is a debt instrument that provides for one or more payments that are contingent as to timing or amount. If you hold a contingent payment debt instrument, you must report OID as it accrues each year.

Because the actual payments on a contingent payment debt instrument cannot be known in advance, issuers and holders cannot use the constant yield method (discussed earlier under *Debt Instruments Issued After 1984*) without making certain assumptions about the payments on the debt instrument. To figure OID accruals on contingent payment debt instruments, holders and issuers must use the noncontingent bond method.

**Noncontingent bond method.** Under this method, the issuer must construct a hypothetical noncontingent bond that has terms and conditions similar to the contingent payment debt instrument. The issuer constructs the payment schedule of the hypothetical noncontingent bond by projecting a fixed amount for each contingent payment. Holders and issuers accrue OID on this hypothetical noncontingent bond using the constant yield method that applies to fixed payment debt instruments. When a contingent payment differs from the projected fixed amount, the holders and issuers make adjustments to their OID accruals. If the actual contingent payment is

larger than expected, both the issuer and the holder increase their OID accruals. If the actual contingent payment is smaller than expected, holders and issuers generally decrease their OID accruals.

**Form 1099–OID.** The amount shown in box 1 of the Form 1099–OID you receive for a contingent payment debt instrument may not be the correct amount to include in income. For example, the amount may not be correct if the contingent payment was different from the projected amount. If the amount in box 1 is not correct, you must figure the OID to report on your return under the following rules. For information on showing an OID adjustment on your tax return, see *How To Report OID*, earlier.

**Figuring OID.** To figure OID on a contingent payment debt instrument, you need to know the “comparable yield” and “projected payment schedule” of the debt instrument. The issuer must make these available to you.

**Comparable yield.** The comparable yield is the yield on the hypothetical noncontingent bond that the issuer determines and constructs at the time of issuance.

**Projected payment schedule.** The projected payment schedule is the payment schedule of the hypothetical noncontingent bond. The schedule includes all fixed payments due under the contingent payment debt instrument and a projected fixed amount for each contingent payment. The projected payment schedule is created by the issuer. It is used to determine the holder’s interest accruals and adjustments.

**Steps for figuring OID.** Figure the OID on a contingent payment debt instrument in two steps.

- 1) Figure the OID on the hypothetical noncontingent bond using the constant yield method (discussed earlier under *Debt Instruments Issued After 1984*) that applies to fixed payment debt instruments. Use the comparable yield as the yield to maturity. Use the projected payment schedule to determine the hypothetical bond’s adjusted issue price at the beginning of the accrual period. Do not treat any amount payable as qualified stated interest.
- 2) Adjust the OID in (1) to account for actual contingent payments. If the contingent payment is greater than the projected fixed amount, you have a positive adjustment. If the contingent payment is less than the projected fixed amount, you have a negative adjustment.

**Net positive adjustment.** A net positive adjustment exists when the total of any positive adjustments described in (2) above exceeds the total of any negative adjustments. Treat a net positive adjustment as additional OID for the tax year.

**Net negative adjustment.** A net negative adjustment exists when the total of any negative adjustments described in (2) above is more than the total of any positive adjustments. Use a net negative adjustment to offset OID on the debt instrument for the tax year. If the net negative adjustment is more than the OID on the debt instrument for the tax year, you can claim the

difference as an ordinary loss. However, the amount you can claim as an ordinary loss is limited to the OID on the debt instrument you included in income in prior tax years. You must carry forward any net negative adjustment that is more than the total OID for the tax year and prior tax years and treat it as a negative adjustment in the next tax year.

**Basis adjustments.** In general, increase your basis in a contingent payment debt instrument by the OID included in income. Your basis, however, is not affected by any negative or positive adjustments. Decrease your basis by any noncontingent payment received and the projected contingent payment scheduled to be received.

**Treatment of gain or loss on sale or exchange.** If you sell a contingent payment debt instrument at a gain, your gain is ordinary income (interest income), even if you hold the instrument as a capital asset. If you sell a contingent payment debt instrument at a loss, your loss is an ordinary loss to the extent of your prior OID accruals on the instrument. If the instrument is a capital asset, treat any loss that is more than your prior OID accruals as a capital loss.

See section 1.1275–4 of the regulations for exceptions to these rules.

**Premium, acquisition premium, and market discount.** The rules for accruing premium, acquisition premium, and market discount do not apply to a contingent payment debt instrument. See section 1.1275–4 of the regulations to determine how to account for these items.

## Inflation-Indexed Debt Instruments

This discussion shows how you figure OID on certain inflation-indexed debt instruments issued after January 5, 1997. An **inflation-indexed debt instrument** is generally a debt instrument on which the payments are adjusted for inflation and deflation (such as Treasury inflation-indexed securities).

In general, if you hold an inflation-indexed debt instrument, you must report as OID any increase in the inflation-adjusted principal amount of the instrument that occurs while you held the instrument during the tax year. You must include the OID in gross income whether or not you hold the instrument as a capital asset. Your basis in the instrument is increased by the OID you include in income.

**Inflation-adjusted principal amount.** For any date, the inflation-adjusted principal amount of an inflation-indexed debt instrument is the instrument’s outstanding principal amount multiplied by the index ratio for that date. For this purpose, determine the outstanding principal amount as if there were no inflation or deflation over the term of the instrument.

**Index ratio.** This is a fraction, the numerator of which is the value of the reference index for the date and the denominator of which is the value of the reference index for the instrument’s issue date.

A **qualified reference index** measures inflation and deflation over the term of a debt instrument. Its value is reset each month to a current value of a single qualified inflation index (for example, the nonseasonally adjusted U.S. City Average All Items Consumer Price Index for All Urban Consumers (CPI-U), published by the

Bureau of Labor Statistics of the Department of Labor). The value of the index for any date between reset dates is determined through straight-line interpolation.



The daily index ratios for Treasury inflation-indexed securities are available on the Internet at [www.publicdebt.treas.gov](http://www.publicdebt.treas.gov).

**Form 1099–OID.** The amount shown in box 6 of the Form 1099–OID you receive for an inflation-indexed debt instrument may not be the correct amount to include in income. For example, the amount may not be correct if you bought the debt instrument (other than at original issue) or sold it during the year. If the amount shown in box 6 is not correct, you must figure the OID to report on your return under the following rules. For information about showing an OID adjustment on your tax return, see *How To Report OID*, earlier.

**Figuring OID.** Figure the OID on an inflation-indexed debt instrument using one of the following methods.

- The **coupon bond method**, described in the following discussion, applies if the instrument is issued at par, all stated interest payable on the instrument is qualified stated interest, and the coupons have not been stripped from the instrument. This method generally applies, for example, to Treasury inflation-indexed securities.
- The **discount bond method** applies to any inflation-indexed debt instrument that does not qualify for the coupon bond method, such as a stripped instrument. This method is described in section 1.1275–7(e) of the regulations.

Under the coupon bond method, figure the OID you must report for the tax year as follows.

**Debt instrument held at the end of the tax year.** If you held the debt instrument at the end of the tax year, figure your OID for the year using the following steps.

- 1) Add the inflation-adjusted principal amount for the day after the last day of the tax year and any principal payments you received during the year.
- 2) Subtract from (1) above the inflation-adjusted principal amount for the first day on which you held the instrument during the tax year.

**Debt instrument sold or retired during the tax year.** If you sold the debt instrument during the tax year, or if it was retired, figure your OID for the year using the following steps.

- 1) Add the inflation-adjusted principal amount for the last day on which you held the instrument during the tax year and any principal payments you received during the year.
- 2) Subtract from (1) above the inflation-adjusted principal amount for the first day on which you held the instrument during the tax year.

**Example 18.** On February 6, 2001, you bought a 10-year, 3.375% inflation-indexed debt

instrument for \$9,831. The stated principal amount is \$10,000 and the inflation-adjusted principal amount for February 6, 2001, is \$10,010.40. You held the debt instrument until September 1, 2001, when the inflation-adjusted principal amount was \$10,116.50. Your OID for the 2001 tax year is \$106.10 (\$10,116.50 – \$10,010.40). Your basis in the debt instrument on September 1, 2001, was \$9,937.10 (\$9,831 cost + \$106.10 OID for 2001).

**Stated interest.** Under the coupon bond method, you report any stated interest on the debt instrument under your regular method of accounting. For example, if you use the cash method, you generally include in income for the tax year any interest payments received on the instrument during the year.

**Deflation adjustments.** If your calculation to figure OID on an inflation-indexed debt instrument produces a negative number, you do not have any OID. Instead, you have a deflation adjustment. A deflation adjustment generally is used to offset interest income from the debt instrument for the tax year. Show this offset as an adjustment on your Schedule B (Form 1040), in the same way you would show an OID adjustment. See *How To Report OID*, earlier.

You decrease your basis in the debt instrument by the deflation adjustment used to offset interest income.

**Example 19.** Assume the same facts as in *Example 18*, except that you bought the instrument on July 1, 2001, when the inflation-adjusted principal amount was \$10,111.40, and sold the instrument on August 1, 2001, when the inflation-adjusted principal amount was \$10,105.10. Because the OID calculation for 2001 (\$10,105.10 – \$10,111.40) produces a negative number (negative \$6.30), you have a deflation adjustment. You use this deflation adjustment to offset the stated interest reported to you on the debt instrument.

Your basis in the debt instrument on August 1, 2001, is \$9,824.70 (\$9,831 cost – \$6.30 deflation adjustment for 2001).

**Premium on inflation-indexed debt instruments.** In general, any premium on an inflation-indexed debt instrument is determined as of the date you acquire the instrument by assuming there will be no further inflation or deflation over the remaining term of the instrument. You allocate any premium over the remaining term of the instrument by making the same assumption. In general, the premium allocable to a tax year offsets the interest otherwise includible in income for the year. If the premium allocable to the year is more than that interest, the difference generally offsets the OID on the instrument for the year.

## Figuring OID on Stripped Bonds and Coupons

If you strip one or more coupons from a bond and then sell or otherwise dispose of the bond or the stripped coupons, they are treated as separate debt instruments issued with OID. The holder of a stripped bond has the right to receive the principal (redemption price) payment. The holder of a stripped coupon has the right to receive an interest payment on the bond. The

rule requiring the holder of a debt instrument issued with OID to include the OID in gross income as it accrues applies to stripped bonds and coupons acquired after July 1, 1982. See *Bonds and Coupons Purchased After July 1, 1982, and Before 1985* or *Bonds and Coupons Purchased After 1984*, later, for information about figuring the OID to report.

Stripped bonds and coupons include the following instruments.

- Zero coupon instruments available through the Department of the Treasury's STRIPS program and government-sponsored enterprises such as the Resolution Funding Corporation and the Financing Corporation.
- Instruments backed by U.S. Treasury securities that represent ownership interests in those securities. Examples include obligations backed by U.S. Treasury bonds that are offered primarily by brokerage firms (variously called CATS, TIGRs, etc.).

**Seller of stripped bond or coupon.** If you strip coupons from a bond and sell the bond or coupons, include in income the interest that accrued while you held the bond before the date of sale to the extent the interest was not previously included in your income. For an obligation acquired after October 22, 1986, you must also include the market discount that accrued before the date of sale of the stripped bond (or coupon) to the extent the discount was not previously included in your income.

Add the interest and market discount you include in income to the basis of the bond and coupons. This adjusted basis is then allocated between the items you keep and the items you sell, based on the fair market value of the items. The difference between the sale price of the bond (or coupon) and the allocated basis of the bond (or coupon) is the gain or loss from the sale.

Treat any item you keep as an OID bond originally issued and purchased by you on the sale date of the other items. If you keep the bond, treat the excess of the redemption price of the bond over the basis of the bond as OID. If you keep the coupons, treat the excess of the amount payable on the coupons over the basis of the coupons as OID.

**Purchaser of stripped bond or coupon.** If you purchase a stripped bond or coupon, treat it as if it were originally issued on the date of purchase. If you purchase the stripped bond, treat as OID any excess of the stated redemption price at maturity over your purchase price. If you purchase the stripped coupon, treat as OID any excess of the amount payable on the due date of the coupon over your purchase price.

## Form 1099–OID

The amount shown in box 6 of the Form 1099–OID you receive for a stripped bond or coupon may not be the proper amount to include in income. If not, you must figure the OID to report on your return under the rules that follow. For information about showing an OID adjustment on your tax return, see *How To Report OID*, earlier.

## Tax-Exempt Bonds and Coupons

The OID on a stripped tax-exempt bond, or on a stripped coupon from such a bond, is generally not taxable. However, if you acquired the stripped bond or coupon after October 22, 1986, you must accrue OID on it to determine its basis when you dispose of it. How you figure accrued OID and whether any OID is taxable depend on the date you bought (or are treated as having bought) the stripped bond or coupon.

**Acquired before June 11, 1987.** None of the OID on bonds or coupons acquired before this date is taxable. The accrued OID is added to the basis of the bond or coupon. The accrued OID is the amount that produces a yield to maturity (YTM), based on your purchase date and purchase price, equal to the lower of the following rates.

- 1) The coupon rate on the bond before the separation of coupons. (However, if you can establish the YTM of the bond (with all coupons attached) at the time of its original issue, you can use that YTM instead.)
- 2) The YTM of the stripped bond or coupon.

Increase your basis in the stripped tax-exempt bond or coupon by the interest that accrued but was neither paid nor previously reflected in your basis before the date you sold the bond or coupon.

**Acquired after June 10, 1987.** Part of the OID on bonds or coupons acquired after this date may be taxable. Figure the taxable part in three steps.

**Step 1 — Figure OID as if all taxable.** First figure the OID following the rules in this section as if all the OID were taxable. (See *Bonds and Coupons Purchased After 1984*, later.) Use the yield to maturity (YTM) based on the date you obtained the stripped bond or coupon.

**Step 2 — Determine nontaxable part.** Find the issue price that would produce a YTM as of the purchase date equal to the lower of the following rates.

- 1) The coupon rate on the bond from which the coupons were separated. (However, you can use the original YTM instead.)
- 2) The YTM based on the purchase price of the stripped coupon or bond.

Subtract this issue price from the stated redemption price of the bond at maturity (or, in the case of a coupon, the amount payable on the due date of the coupon). The result is the part of the OID treated as OID on a stripped tax-exempt bond or coupon.

**Step 3 — Determine taxable part.** The taxable part of OID is the OID determined in Step 1 minus the nontaxable part determined in Step 2.

**Exception.** None of the OID on your stripped tax-exempt bond or coupon is taxable if you bought it from a person who held it for sale on June 10, 1987, in the ordinary course of that person's trade or business.

**Basis adjustment.** Increase the basis of your stripped tax-exempt bond or coupon by the taxable and nontaxable accrued OID. If you own a tax-exempt bond from which one or more

coupons have been stripped, increase your basis in it by the sum of the interest accrued but not paid before you dispose of it (and not previously reflected in basis) and any accrued market discount to the extent not previously included in your income.

**Example 20.** Assume that a tax-exempt bond with a face amount of \$100 due January 1, 2003, and a coupon rate of 10% (compounded semiannually) was issued for \$100 on January 1, 2000. On January 1, 2001, the bond was stripped and you bought the right to receive the principal amount for \$79.21. The stripped bond is treated as if it were originally issued on January 1, 2001, with OID of \$20.79 (\$100.00 – \$79.21). This reflects a YTM at the time of the strip of 12% (compounded semiannually). The tax-exempt part of OID on the stripped bond is limited to \$17.73. This is the difference between the redemption price (\$100) and the issue price that would produce a YTM of 10% (\$82.27). This part of the OID is treated as OID on a tax-exempt obligation.

The OID on the stripped bond that is more than the tax-exempt part is \$3.06. This is the excess of the total OID (\$20.79) over the tax-exempt part (\$17.73). This part of the OID (\$3.06) is treated as OID on an obligation that is not tax exempt.

The total OID allocable to the accrual period ending June 30, 2001, is \$4.75 (6% × \$79.21). Of this, \$4.11 (5% × \$82.27) is treated as OID on a tax-exempt obligation and \$0.64 (\$4.75 – \$4.11) is treated as OID on an obligation that is not tax exempt. Your basis in the bond is increased to \$83.96 (\$79.21 issue price + accrued OID of \$4.75).

## Bonds and Coupons Purchased After July 1, 1982, and Before 1985

If you purchased a stripped bond or coupon after July 1, 1982, and before 1985, and you held that debt instrument as a capital asset during any part of 2001, you must figure the OID to be included in income using a **constant yield method**. Under this method, OID is allocated over the time you hold the debt instrument by adjusting the acquisition price for each accrual period. The OID for the accrual period is figured by multiplying the adjusted acquisition price at the beginning of the period by the yield to maturity.

**Adjusted acquisition price.** The adjusted acquisition price of a stripped bond or coupon at the beginning of the first accrual period is its purchase (or acquisition) price. The adjusted acquisition price at the beginning of any subsequent accrual period is the sum of the acquisition price and all of the OID includable in income before that accrual period.

**Accrual period.** An accrual period for any stripped bond or coupon acquired before 1985 is each 1-year period beginning on the date of the purchase of the obligation and each anniversary thereafter, or the shorter period to maturity for the last accrual period.

**Yield to maturity (YTM).** In general, the YTM of a stripped bond or coupon is the discount rate that, when used in figuring the present value of all principal and interest payments, produces an

amount equal to the acquisition price of the bond or coupon.

**Figuring YTM.** If you purchased a stripped bond or coupon after July 1, 1982, but before 1985, and the period from your purchase date to the day the instrument matures can be divided exactly into full 1-year periods without including a shorter period, then the YTM can be figured by applying the following formula.

$$\left( \frac{\text{srp}}{\text{ap}} \right)^{\frac{1}{m}} - 1$$

**srp** = stated redemption price at maturity

**ap** = acquisition price

**m** = number of full accrual periods from purchase to maturity

If the instrument is a stripped coupon, the stated redemption price is the amount payable on the due date of the coupon. See *Example 21*.

If the period between your purchase date and the maturity date (or due date) of the instrument does not divide into an exact number of full 1-year periods, so that a period shorter than 1 year must be included, consult your broker or your tax advisor for information about figuring the YTM.

**Example 21.** On November 15, 1984, you bought a coupon stripped from a U.S. Treasury bond through the Department of the Treasury's STRIPS program for \$20,000. An amount of \$100,000 is payable on the coupon's due date, November 14, 2009. There are exactly 25 1-year periods between the purchase date, November 15, 1984, and the coupon's due date, November 14, 2009. Your YTM on this stripped coupon is figured as follows.

$$\left( \frac{\$100,000}{\$20,000} \right)^{1/25} - 1 = (1.06649 - 1) = 0.06649 = 6.649\%$$

Use 6.649% YTM to figure the OID for each accrual period or partial accrual period for which you must report OID.

**Daily OID.** The OID for any accrual period is allocated equally to each day in the accrual period. You figure the amount to include in income by adding the daily OID amounts for each day you hold the debt instrument during the year. If your tax year includes parts of more than one accrual period (which will be the case unless the accrual period coincides with your tax year), you must include the proper daily OID amounts for each of the two accrual periods.

The daily OID for the **initial accrual period** is figured by applying the following formula.

$$\frac{(\text{ap} \times \text{ytm})}{p}$$

**ap** = acquisition price

**ytm** = yield to maturity

**p** = number of days in accrual period

The daily OID for **subsequent accrual periods** is figured in the same way except the adjusted acquisition price at the beginning of each period is used in the formula instead of the acquisition price.

The rules for figuring OID on these instruments are similar to those illustrated in *Example*

9 and Example 10, earlier, under *Debt Instruments Issued After July 1, 1982, and Before 1985*.

## Bonds and Coupons Purchased After 1984

If you purchased a stripped bond or coupon (other than a stripped inflation-indexed instrument) after 1984, and you held that debt instrument during any part of 2001, you must figure the OID to be included in income using a **constant yield method**. Under this method, OID is allocated over the time you hold the debt instrument by adjusting the acquisition price for each accrual period. The OID for the accrual period is figured by multiplying the adjusted acquisition price at the beginning of the period by a fraction. The numerator of the fraction is the instrument's yield to maturity and the denominator is the number of accrual periods per year.

If the stripped bond or coupon is an inflation-indexed instrument, you must figure the OID to be included in income using the discount bond method described in section 1.1275(e) of the regulations.

**Adjusted acquisition price.** The adjusted acquisition price of a stripped bond or coupon at the beginning of the first accrual period is its purchase (or acquisition) price. The adjusted acquisition price at the beginning of any subsequent accrual period is the sum of the acquisition price and all of the OID includible in income before that accrual period.

**Accrual period.** For a stripped bond or coupon acquired after 1984 and before April 4, 1994, an accrual period is each 6-month period that ends on the day that corresponds to the stated maturity date of the stripped bond (or payment date of a stripped coupon) or the date 6 months before that date. For example, a stripped bond that has a maturity date (or a stripped coupon that has a payment date) of March 31 has accrual periods that end on September 30 and March 31 of each calendar year. Any short period is included as the first accrual period.

For a stripped bond or coupon acquired after April 3, 1994, accrual periods may be of any length and may vary in length over the term of the instrument, as long as each accrual period is no longer than 1 year and all payments are made on the first or last day of an accrual period.

**Yield to maturity (YTM).** In general, the YTM of a stripped bond or coupon is the discount rate that, when used in figuring the present value of all principal and interest payments, produces an amount equal to the acquisition price.

**Figuring YTM.** How you figure the YTM for a stripped bond or coupon purchased after 1984 depends on whether you have equal accrual periods or a short initial accrual period.

**1) Equal accrual periods.** If the period from the date you purchased a stripped bond or coupon to the maturity date can be divided evenly into full accrual periods without including a shorter period, you can figure the YTM by using the following formula.

$$n \times \left( \left( \frac{srp}{ap} \right)^{1/m} - 1 \right)$$

**n** = number of accrual periods in 1 year  
**srp** = stated redemption price at maturity  
**ap** = acquisition price  
**m** = number of full accrual periods from purchase to maturity

If the instrument is a stripped coupon, the stated redemption price is the amount payable on the due date of the coupon.

**Example 22.** On May 15, 1990, you bought a coupon stripped from a U.S. Treasury bond through the Department of the Treasury's STRIPS program for \$38,000. An amount of \$100,000 is payable on the coupon's due date, November 14, 2002. There are exactly 25 6-month periods between the purchase date, May 15, 1990, and the coupon's due date, November 14, 2002. The YTM on this stripped coupon is figured as follows.

$$2 \times \left( \left( \frac{\$100,000}{\$38,000} \right)^{1/25} - 1 \right) = 2 \times (1.03946 - 1) = 0.07892 = 7.892\%$$

Use 7.892% YTM to figure the OID for each accrual period or partial accrual period for which you must report OID.

**2) Short initial accrual period.** If the period from the date you purchased a stripped bond or coupon to the date of its maturity cannot be divided evenly into full accrual periods, so that a shorter period must be included, you can figure the YTM by using the following formula (the **exact method**).

$$n \times \left( \left( \frac{srp}{ap} \right)^{\left( \frac{r}{s} + m \right)} - 1 \right)$$

**n** = number of accrual periods in 1 year  
**srp** = stated redemption price at maturity  
**ap** = acquisition price  
**r** = number of days from purchase to end of short accrual period  
**s** = number of days in accrual period ending on last day of short accrual period  
**m** = number of full accrual periods from purchase to maturity

**Example 23.** On June 1, 2001, you bought a coupon stripped from a U.S. Treasury bond through the Department of the Treasury's STRIPS program for \$60,000. \$100,000 is payable on the coupon's due date, August 13, 2007. You decide to figure OID using 6-month accrual periods. There are 12 full 6-month accrual periods and a 74-day short initial accrual period from the purchase date to the coupon's due date. The YTM on this stripped coupon is figured as follows.

$$2 \times \left( \left( \frac{\$100,000}{\$60,000} \right)^{\left( \frac{1}{(74/181) + 12} \right)} - 1 \right) = 2 \times (1.04203 - 1) = .08406 = 8.406\%$$

Use 8.406% YTM to figure the OID for each accrual period or partial accrual period for which you must report OID.

**Daily OID.** The OID for any accrual period is allocated equally to each day in the accrual period. You must include in income the sum of

the daily OID amounts for each day you hold the debt instrument during the year. Since your tax year will usually include parts of two or more accrual periods, you must include the proper daily OID amounts for each accrual period.

**Figuring daily OID.** For the **initial accrual period** of a stripped bond or coupon acquired after 1984, figure the daily OID using *Formula 1*, next, if there are equal accrual periods. Use *Formula 2* if there is a short initial accrual period.

For **subsequent accrual periods**, figure the daily OID using *Formula 1* (whether or not there was a short initial accrual period), but use the adjusted acquisition price in the formula instead of the acquisition price.

**Formula 1 —**

$$\frac{ap \times ytm / n}{p}$$

**Formula 2 —**

$$\frac{ap \times (1 + ytm / n) - ap}{r} \times \frac{r}{s}$$

**ap** = acquisition price  
**ytm** = yield to maturity  
**n** = number of accrual periods in 1 year  
**p** = number of days in accrual period  
**r** = number of days from purchase to end of short accrual period  
**s** = number of days in accrual period ending on last day of short accrual period

The rules for figuring OID on these instruments are similar to those illustrated in *Example 15* and *Example 16*, earlier, under *Debt Instruments Issued After 1984*.

**Example 24.** Assume the same facts as in *Example 23*, and that you held the coupon for the rest of 2001.

For the short initial accrual period from June 1, 2001, through August 13, 2001 the daily OID is figured using *Formula 2*, as follows.

$$\frac{\$60,000 \times (1 + .08406/2) - \$60,000}{74} = \frac{\$1,018.20}{74} = \$13.75946$$

The OID for this period is \$1,018.20 (\$13.75946 × 74 days).

For the second accrual period from August 14, 2001, through February 13, 2002, the adjusted acquisition price is \$61,018.20. This is the original \$60,000 acquisition price plus \$1,018.20 OID for the short initial accrual period. The daily OID is figured using *Formula 1*, as follows.

$$\frac{\$61,018.20 \times (.08406/2)}{184} = \frac{\$2,564.59495}{184} = \$13.93802$$

The OID for the part of this period included in 2001 (August 14 – December 31) is \$1,951.32 (\$13.93802 × 140 days).

The OID to be reported on your 2001 tax return is \$2,969.52 (\$1,018.20 + \$1,951.32)

**Final accrual period.** The OID for the final accrual period for a stripped bond or coupon is the amount payable at maturity of the stripped bond (or interest payable on the stripped coupon) minus the adjusted acquisition price at the beginning of the final accrual period. The daily OID for the final accrual period is figured by dividing the OID for the period by the number of days in the period.

## How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Contacting your Taxpayer Advocate.** If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.


The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1-877-777-4778**.
- Call the IRS at **1-800-829-1040**.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1-800-829-4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS*.

**Free tax services.** To find out what services are available, get Publication 910, *Guide to Free Tax Services*. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

 **Personal computer.** With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can:

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- Download forms and publications or search for forms and publications by topic or keyword.

- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov**.



**TaxFax Service.** Using the phone attached to your fax machine, you can receive forms and instructions by calling **703-368-9694**. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703-487-4608**.



**Phone.** Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1-800-829-3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1-800-829-1040**.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1-800-829-4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1-800-829-4477** to listen to pre-recorded messages covering various tax topics.

**Evaluating the quality of our telephone services.** To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistant and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying

our customers for their opinions on our service.



**Walk-in.** You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.



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- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1-877-233-6767** or on the Internet at **www.irs.gov**. The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide*, is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1-800-829-3676** or visiting the IRS web site at **www.irs.gov**.

Table 1. Explanation of Section I Column Headings


	1	2	3	4	5	6	7			8	
				Issue Price (Percent of Principal Amount)	Annual Stated Interest Rate	Total OID to 1/1/01	Daily OID per \$1,000 of Maturity Value for Each Accrual Period			OID per \$1,000 of Maturity Value for Calendar Year	
Name of Issuer	CUSIP Number	Issue Date	Maturity Date				2001 1st Period	2001 2nd & 2002 1st	2002 2nd Period	2001	2002
XYZ Corp.	123456AA	08/01/83	08/01/03	90.0	13.0	68.49	.028399	.032534	.037270	11.00	12.60

- CUSIP Number**—The CUSIP number identifies the debt instrument. The first six digits of the CUSIP number represent the issuer and the last two digits identify the particular issue. The ninth, or check digit, is omitted for most debt instruments issued before 1985.
- Issue Date**—This is the date of original issue, which is generally the date on which the instrument was first sold to the public at the issue price.
- Maturity Date**—This is the date the debt instrument matures and is redeemable at its full principal amount. For example, if the bond of XYZ Corp. above has a principal amount of \$1,000, the holder will be paid \$1,000 when he or she redeems it on August 1, 2003 (maturity date).
- Issue Price (Percent of Principal Amount)**—In general, the issue price is the initial offering price at which a substantial amount of the debt instruments are sold to the public. In the above example, XYZ bonds were first offered to the public at \$900. Since they have a principal amount of \$1,000, the issue price expressed as a percent of principal amount is 90.
- Annual Stated Interest Rate**—This is the rate of annual interest payments. In the above example, XYZ bond has a stated interest rate of 13% and pays \$130 a year for each \$1,000 principal amount of the bond.
- Total OID to 1/1/01**—This shows the total OID accumulated on the debt instrument from the date of original issue to 1/1/00. (This information is not available for all instruments listed.)
- Daily OID in 2001 and 2002**—This is the OID for each day you held the debt instrument during the accrual periods falling in 2001 and 2002. (The daily OID for the second accrual period in 2001 and the first accrual period in 2002 are identical.) For corporate debt instruments issued after July 1, 1982, and before 1985, an accrual period is a 1-year period beginning on the same month and day as the date of issue of the instrument. In the above example, the first

accrual period shown for 2001 for XYZ bond is 8/1/00-7/31/01. The part of this accrual period that falls in 2001 is from 1/1/01-7/31/01. For each \$1,000 principal amount of the bond, the OID is .028399 each day you held the bond during this accrual period. Similarly, the part of the second accrual period in 2001 is from 8/1/01-12/31/01. The OID is .032534 for each day you held the bond during this accrual period. The OID for each day you held a debt instrument in 2002 is determined in the same manner, using the daily OID applicable to the part of each accrual period falling in 2002. If you bought the debt instrument after original issue and paid an acquisition premium, see *Debt Instruments Issued After July 1, 1982, and Before 1985*, earlier, for more information.

**NOTE.** For corporate debt instruments issued after 1984 (listed in Section I-B), the columns for the daily OID amounts are increased to include the number of 6-month accrual periods that apply to these instruments during 2001 and 2002. The 2001 OID is determined by using the daily OID for the 3 periods for the year. Although each accrual period is 6 months long, a 6-month period may extend into the next calendar year.

- OID for 2001 and 2002 (Per \$1,000 of Maturity Value)**—The amount appearing in the 2001 column is the total OID if you held the instrument the entire year or the part it was outstanding. For debt instruments entirely called or maturing in 2001, the amount is computed to the date of call or maturity. In the above example, if you held XYZ bond for all of 2001, the OID is \$11.00 for each \$1,000 principal amount of the bond. If you did not hold the bond for the entire year, use the daily OID for each accrual period in 2001. (See *Figuring OID*, earlier, for more detailed information.) Similarly, the amount appearing in the 2002 column is the total OID if you held the instrument for the entire year or the part it was outstanding. If you bought the instrument after original issue and paid an acquisition premium, see *Debt Instruments Issued After July 1, 1982, and Before 1985*, earlier, for more information.

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