Department of the Treasury

Internal Revenue Service

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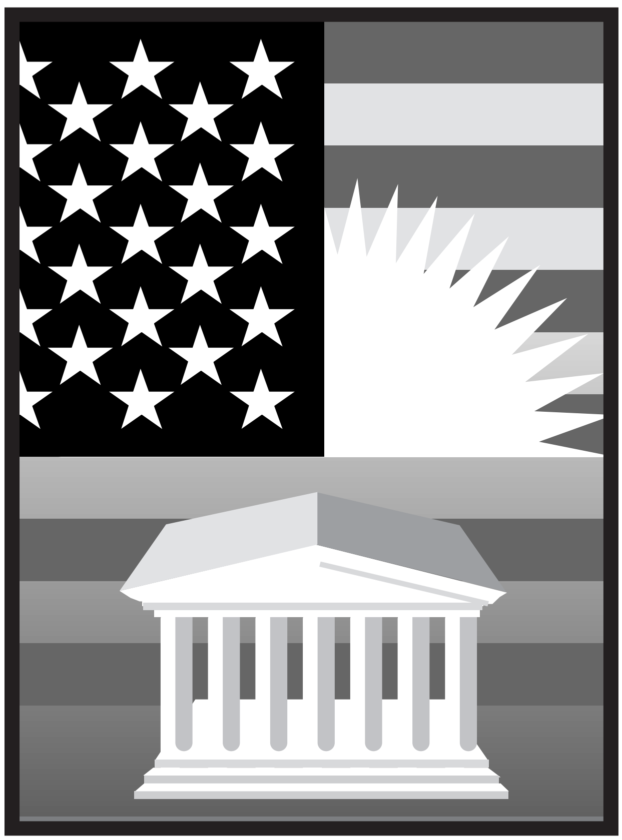
List of Original Issue Discount Instruments

For use in preparing

1998 Returns



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See *How To Get More Information* in this publication.

Contents

Important Reminders

Individual taxpayer identification number (ITIN). The IRS will issue an ITIN to a nonresident or a U.S. resident alien (based on substantial presence) who does not have and is not eligible to get a social security number (SSN). To apply for an ITIN, an alien must file Form W-7 with the IRS. It usually takes about 30 days to get an ITIN. The ITIN is entered wherever an SSN is requested on a tax return. If you are required to include another person's SSN on your return and that person does not have one and cannot get one, enter that person's ITIN.

An ITIN is for tax use only. It does not entitle the holder to social security benefits or change the holder's employment or immigration status under U.S. law.

OID accrual periods. For debt instruments issued after April 3, 1994, accrual periods used to figure original issue discount (OID) 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 one 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 because of space limitations. When preparing Forms 1099–OID for these instruments, brokers and other middlemen can use the amounts listed in *Section I–B* or refigure the OID using the actual accrual periods of the instrument. See *Figuring OID,* in the discussion on long-term debt instruments under *Information for Brokers and Other Middlemen,* later.

OID list available on electronic bulletin board. The original issue discount (OID) list at the end of this publication is also available electronically for the convenience of brokers and middlemen. You can download this list from the electronic bulletin board (IRP-BBS) maintained in Martinsburg, WV. Using your modem, dial 1–304–264–7070 and follow the instructions. This is not a toll-free call.

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.

Publication 938 is available from the electronic bulletin board (IRP-BBS) maintained in Martinsburg, W V. Use your modem to dial 1–304–264– 7070.

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

Introduction

The primary purpose of this publication is to help brokers and other middlemen identify publicly offered ***original issue discount (OID)*** debt instruments, which 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 is to assist owners of publicly offered OID debt instruments to determine the OID to report on their income tax returns.

This publication contains a list of OID debt instruments. The information on this list comes from financial publications and from the issuers of the debt instruments. Issuers of certain publicly offered OID debt instruments must report this information directly to the IRS on Form 8281 within 30 days after the issue date. The information provided on that form enables the IRS to update this list annually. (However, see *Debt Instruments Not on the OID List,* later.)

The information on the OID list has generally not been verified by an IRS examination or rulings action. Issuers and their paying agents should not assume that the information has been verified by the IRS as correct.

Issuers should advise the IRS of errors in and omissions from the list in writing at the following address:

OID Publication Project
OP:FS:FP:P Room 5607
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Brokers and other middlemen can rely on this published OID list to determine, for information reporting purposes, if a debt instrument was issued at a discount and the OID to be reported on information returns. However, the following are subject to change upon examination by the IRS.

- The OID reported by holders on their income tax returns.
- Whether an issuer's classification of an instrument as debt for federal income tax purposes is correct.

Useful Items

You may want to see:

Publication

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

Form (and Instructions)

- ☐ **W–8** Certificate of Foreign Status
- ☐ **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
- ☐ **8281** Information Return for Publicly Offered Original Issue Discount Instruments

See *How To Get More Information* on page 14 for information about getting these publications and forms.

Structure of the OID List

The list has the following sections.

- **Section I** 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. *Section I–C* lists inflation-indexed debt instruments issued after January 5, 1997.

  Brokers and other middlemen may use *Section I* to prepare information returns for 1998.

  Owners of these debt instruments should not rely on the OID listed in *Section I* to determine (or compare) OID to be reported on their tax return. The amounts listed in *Section I* are figured without reference to the price or date at which an owner acquired the debt instrument. For information about determining the OID to be reported on your tax return, see *Figuring OID on Long-Term Debt Instruments,* later.

- **Section II** lists zero coupon instruments available through the Department of the Treasury's STRIPS program and government-sponsored enterprises such as the Resolution Funding Corporation. It also includes instruments backed by U.S. Treasury securities that represent ownership interests in those securities.

  Brokers and other middlemen may use *Section II* to prepare information returns for 1998. They should not rely on the information in *Section II* of previous editions of Publication 1212 to prepare information returns for 1998.

  Owners of these debt instruments should not rely on the OID listed in *Section II* to determine (or compare) OID to be reported on their tax return. The amounts listed in *Section II* are figured without reference to the price or date at which an owner acquired the debt instrument. For information about determining the OID on zero coupon instruments to be reported on your tax return, see *Figuring OID on Stripped Bonds and Coupons,* later.

- **Section III** contains short-term discount obligations. *Section III–A* lists short-term discount obligations issued by the U.S. Treasury Department. These generally are referred to as Treasury bills or T-bills. *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, Federal Home Loan Mortgage Corporation, and the Federal Agricultural Mortgage Corporation.

Debt Instruments Not on the OID List

The list of debt instruments does not contain the following.

- 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 1998.
- 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 that are not Treasury Inflation-Indexed Securities. (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. (These debt instruments are not subject to the OID information reporting rules.)
- REMIC regular interests and CDOs.
- Commercial paper and banker's acceptances that may have been originally 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 currently available or that were issued in late 1998 after publication of this list. These will be included in the next revision of the publication.

Information on the OID List

This section describes the information in each part of the list.

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

- The name of the issuer.
- The 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. (Shown as 0.00 if no annual interest payments are provided.)
- The total OID up to January 1, 1998. (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 1998 and 1999.
- The total OID per $1,000 of principal or maturity value for calendar years 1998 and 1999.

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

Section II. This section lists the OID to be reported by brokers and other middlemen for calendar year 1998 for stripped components of instruments available through the U.S. Treasury and government-sponsored enterprises. (See *Structure of the OID List,* earlier, for more information about these instruments.) The amounts listed are per $1,000 redemption price and are arranged by maturity date.

Section III. The short-term obligations listed in this section are arranged by maturity date. *Section III* lists the CUSIP number, maturity date, issue date, noncompetitive issue price (as percent of principal), and discount to be reported as interest for calendar year 1998 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.

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 true owner.

In general, you must file a Form 1099 for the debt instrument if the interest or OID to be included in the holder's income for 1998 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 holder of the debt instrument by February 1, 1999. By March 1, 1999, 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 instructions for Form 1099.

Short-Term Obligations Redeemed at Maturity

If a short-term discount obligation is redeemed at maturity through a broker or other middleman for the true owner, the broker or middleman must report the discount as interest on Form 1099–INT. (If the obligation is sold before maturity, the broker effecting the transaction must file Form 1099–B to reflect the gross proceeds to the seller. The accrued discount to the date of sale is ***not*** reported on either Form 1099–INT or Form 1099–OID.)

When the obligation is redeemed at maturity, the purchase price shown on the owner's copy of the purchase confirmation receipt or similar record, or the price shown in the transaction records of the middleman, should be used to determine the discount to be reported on Form 1099–INT.

If the owner's purchase price ***cannot*** be determined, the broker or other middleman reports 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 listed in *Section III–A.* Under this rule, the middleman prepares Form 1099–INT by using the noncompetitive (weighted average of accepted auction bids) discount price for the longest-maturity Treasury bill maturing on that date. This price is shown in *Section III–A.*

A similar rule applies to the short-term discount obligations issued by the organizations listed in *Sections III–B* through *III–G.*

Information that supplements *Section III–A* is available semiannually from the electronic bulletin board (IRP-BBS) maintained in Martinsburg, WV. Dial, by modem, 1–304–264–7070.

Example 1. Assume there are 13-week, 26-week, and 52-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. In this case, the broker or middleman prepares Form 1099–INT using the noncompetitive discount price (expressed as a percent of principal) in *Section III–A* for a 52–week bill maturing on the same date as the T-bill redeemed. The interest reported is the discount (per $1,000 of principal) shown for that obligation.

Long-Term Debt Instruments

A broker or other middleman who holds a long-term OID debt instrument as a nominee for the true owner generally must file Form 1099–OID.

Brokers and other middlemen can rely on *Section I* of the OID list to determine the following for information reporting purposes.

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

In general, brokers and other middlemen must report OID on publicly offered, long-term debt instruments that are listed in *Section I.* They also may report OID on other long-term debt instruments. *Section I* of the OID list.

Form 1099–OID. Form 1099–OID for 1998 must show the following information.

- Box 1. The OID for the actual dates of ownership of the holder during 1998. To determine the amount of OID to report, 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 of box 2 of Form 1099–OID.
- Box 3. Any interest or principal forfeited because of an early withdrawal that the recipient 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 (e.g., NYSE XYZ 12½ 99). If the issuer of the instrument is other than the payer, show the name of the issuer in this box.

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 holder 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 OID amount to reflect the stated redemption price at maturity of the holder's debt instrument. For example, if the holder's instrument has $500 of stated redemption price at maturity, report one-half of the OID shown for the calendar year.

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

- Look up the daily OID amount for the first 1998 accrual period during which the holder held the instrument.
- Multiply the daily OID amount by the number of days in 1998 that the holder held the instrument during that accrual period.
- Repeat steps (1) and (2) for any remaining 1998 accrual periods during which the holder held the instrument.
- Add the results in steps (2) and (3) to determine the holder's OID per $1,000 of stated redemption price at maturity.
- If necessary, adjust the amount of OID to reflect the stated redemption price at maturity of the holder's debt instrument.

Report the result as OID 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 Internal Revenue Code sections 1272 through 1275. 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 *Information for Owners of OID Debt Instruments,* later.

Inflation-indexed debt instruments. If you use *Section I-C* instead of the Income Tax Regulations to figure the OID on an inflation-indexed debt instrument, you must attach the following statement to the Form 1099–OID you send to the payee.

"If you (the owner) purchased or sold an inflation-indexed debt instrument during the calendar year (other than a purchase at original issue), the OID reported to you may be incorrect. To determine the correct amount of OID, see Publication 1212."

Certificates of Deposit

Any broker or middleman who holds a bank certificate of deposit (CD) as a nominee must determine whether the CD has OID and the amount of OID includible in the income of the owner. The broker or middleman must file an information return showing the reportable interest and OID, if any, on the CD. These rules apply whether or not the broker or middleman 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

A broker, financial institution, or other servicing agency should report the interest paid on a coupon from a bearer bond on a Form 1099–INT identifying the owner of the coupon (unless the owner of the coupon is a foreign person) if both of the following apply.

- The coupon is presented to the servicing agency for collection before the bond matures.
- The servicing agency does not hold the bond as a nominee for the true owner.

Because the servicing agency cannot assume the presenter of the coupon also owns the bond, the servicing agency 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 the servicing agency for redemption upon call or maturity, the servicing agency 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.

Payments outside the United States. Backup withholding and information reporting are not required if the payment or collection of portfolio interest or OID on a bearer bond or coupon is made outside the United States by a broker, financial institution, or servicing agency that is the issuer or the issuer's agent, unless the payer actually knows that the payee is a U.S. person. See Publication 515 for more information on portfolio interest.

Backup withholding and information reporting also are not required for payment or collection of interest or OID on a bearer bond or coupon outside the United States by a custodian, nominee, or other agent of the payee if the agent has documentary evidence that the payee is a foreign person. The agent should disregard the documentary evidence if the agent actually knows the payee is not a foreign person.

However, the requirement for backup withholding and information reporting apply if the custodian, nominee, or other agent is a U.S. person, controlled foreign corporation, or a foreign person at least 50 percent of whose income for the preceding 3–year period is effectively connected with the conduct of a U.S. trade or business.

Backup Withholding

A broker or other middleman who reports OID on Form 1099–OID interest on Form 1099–INT may be required to apply backup withholding to the reportable payment at a 31% rate. 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 fails to furnish his or her taxpayer identification number (TIN) to the middleman.
2) The IRS notifies the middleman that the payee furnished an incorrect TIN.
3) The IRS notifies the middleman that the payee is subject to backup withholding.
4) For instruments acquired after 1983:
   a) The payee fails to certify to the middleman, under penalties of perjury, that he or she is not subject to backup withholding under 3) above.
   b) The payee fails to certify, under penalties of perjury, that his or her TIN 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 the middleman 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 holder of a short-term obligation at maturity is not the original holder 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, the broker 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, the broker 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 withholding is the OID includible in the holder's gross income for the calendar year when the obligation matures. The amount to be withheld is limited to the cash paid.

Registered obligations with cash payments. If a long-term registered obligation has cash payments before maturity, backup withholding applies when a cash payment is made. The amount subject to withholding is the total of the qualified stated interest and OID includible in the holder'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 amount of required withholding is limited to the cash paid.

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

Bearer obligations with cash payments. If a long-term bearer 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 (but not any OID) includible in the holder's gross income for the calendar year. For a payment at maturity, the amount subject to withholding is the total of any qualified stated interest paid at maturity and the OID includible in the holder's gross income for the calendar year when the obligation matures. The amount of required withholding at maturity is limited to the cash paid.

Sales and redemptions. A broker who reports the gross proceeds from a sale, exchange, or redemption of a debt instrument on Form 1099–B may be required to withhold 31% of the amount reported. Backup withholding applies in the following situations.

- The payee does not give a TIN to the broker.
- The IRS notifies the broker 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.

Foreign person. Backup withholding and information reporting are not required for payments of U.S. source OID, interest, or proceeds from sale or redemption of an OID instrument if the payee has given the broker or middleman proof (generally a Form W-8 or an acceptable substitute) that the payee is a foreign person. A U.S. resident is not a foreign person. Form W-8 does not relieve a broker from information reporting and backup withholding if the broker actually knows 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.

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 the broker or middleman a Form W-8 or acceptable substitute as proof that the payee is a foreign person.

See sections 35a.9999–3,–3A,–4, and –5 of the regulations for more information about backup withholding and information reporting on foreign source amounts or payments to foreign persons.

CAUTION *Sections 35a.9999–3,–3A,–4, and –5 of the regulations do not apply after 1998. For information about backup withholding and information reporting after 1998 on foreign source amounts or payments to foreign persons, see the current regulations under Internal Revenue Code sections 3406, 6045, and 6049. Under those regulations, for proof of the payee's foreign status, a broker or middleman can rely on Form W-8 or on documentary evidence for payments made outside the United States to an offshore account or, in the case of broker proceeds, a sale effected outside the United States.*

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 computing 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 for Internal Revenue Code sections 1271 through 1275.

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 that individual to the other individual.) 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.

Definition of OID. A debt instrument, such as a bond or note, generally has OID when the instrument is issued for a price less than its stated redemption price at maturity. OID is a form of interest. The amount of OID is the difference between the stated redemption price at maturity and the issue price of the instrument. 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. In general, stated interest is qualified stated interest if it 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. All debt instruments that pay no interest before maturity (for example, zero coupon bonds) are presumed to be issued at a discount.

Issue price. For instruments listed in this publication, 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.

De minimis rule. You can treat the amount of 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 (stated redemption price) times 10 (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 since the $20 discount you received 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 the discount is more than the $25 de minimis figure in *Example 2.*

Election to report all interest as OID. Generally, you can elect 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* under *Debt Instruments Issued After 1984,* later, for information about this method.

For purposes of this election, 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 Regulations section 1.1272–3 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* in the discussion of *How To Report OID,* later.

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. If you buy a debt instrument at a premium (other than a contingent payment debt instrument or an inflation-indexed debt instrument), you do not report any OID as ordinary income.

Acquisition premium. A debt instrument is purchased at an acquisition premium if both of the following apply.

- It is not purchased at a premium.
- Its adjusted basis immediately after purchase, including purchase at original issue, is greater than its adjusted issue price.

Acquisition premium will reduce the OID you report. For information about how to determine the OID to report for instruments on which you paid an acquisition premium, see the later discussions, definitions, and examples under *Figuring OID on Long-Term Debt Instruments.* Also see *Figuring OID on Long-Term Debt Instruments* for definitions of qualified stated interest and adjusted issue price.

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 (defined earlier) plus the total OID that accrued before you acquired it.

When you dispose of the bond, you must report the gain due to accrued market discount as taxable interest, unless you choose to report it as it accrues. See *Market Discount Bonds* in chapter 1 of Publication 550 for information on how to figure accrued market discount and for other information about market discount bonds. If you elect to use the constant yield method to figure accrued market discount, also see *Figuring OID on Long-Term Debt Instruments* later in this publication. The constant yield method of figuring accrued OID, explained in those discussions under *Figuring OID,* 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 (as discussed later under *Figuring OID on Long-Term Debt Instruments).* 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, 1995, Larry, a calendar year taxpayer, bought a corporate bond at original issue for $86,235.17. The 15-year bond matures on October 31, 2010, 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 less $86,235.17 issue price).

On November 1, 1998, Larry sold the bond for $90,000. With the OID he will report for the period he held the bond in 1998, 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 one year. Form 1099–OID shows the OID income in box 1. It also shows, in box 2, any qualified stated interest (that is not OID) you must include in income. 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.

CAUTION *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 1998 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 of Form 1099–OID to determine the proper amount to include in income if either 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).

Also, you may need to refigure the OID if 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 corporate debt instrument or acquired it from another holder during 1998, 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" recipient. 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 payments for your spouse. See the Form 1099 instructions and *How to Report Interest Income* in chapter 1 of Publication 550 for more information.

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

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. Unless you are a nominee for the actual owner of the instrument, you must use Form 1040 if you are reporting more or less OID than the amount shown on Form 1099–OID. For example, if you paid a premium or an acquisition premium when you purchased the debt instrument, you would report less OID than shown on Form 1099–OID. Also, you must use Form 1040 if you were subject to the early withdrawal penalty.

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.

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 and 2 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.

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.

Figuring OID on Long-Term Debt Instruments

The rules for figuring OID depend on the date the long-term debt instrument was issued. There are different rules for the following.

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.

Note. 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

For these instruments, you do not include OID in income until the year the instrument is sold, exchanged, or redeemed. If a gain results and the instrument is a capital asset, the OID is taxed as ordinary income. 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.

The gain taxed as ordinary income when the instrument is sold, exchanged, or redeemed generally equals the following amount:

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

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 not received. If you held an OID instrument in 1998 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 this figure 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 amount listed to figure your OID.

If you held the instrument the entire year, use the OID shown in *Section I–A* for calendar year 1998. If you did not hold the instrument the entire year, figure your OID using the following method.

1) Divide the OID shown for 1998 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 1998. This is the OID to include in income unless you paid an acquisition premium. The reduction for acquisition premium is discussed later.

If your instrument is not listed in *Section I–A,* consult the issuer for information about the issue price, yield to maturity, and the OID that accrued for 1998.

Acquisition premium. If you bought the instrument for more than the original issue price plus the accumulated OID from the date of issue (but not more than the stated redemption price at maturity), that excess (or acquisition premium) reduces the OID includible in income. In this case, figure the amount 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 ratable monthly portion.
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 amount of OID to include in income for each month you hold the instrument during the year.

See the discussion under *How To Report OID,* earlier, for information about showing an adjustment for OID on your return.

Example 5. On June 1, 1982, Acme Corporation issued 20-year bonds at 90% of the principal amount. On February 1, 1998, you bought Acme bonds with a $10,000 principal amount on the open market for $9,900. The amount you must include in income is figured as follows:

1) Ratable monthly portion ($1,000.00 total OID ÷ 240 months)		$4.17
2) Your cost	$9,900.00	
Minus: Issue price	9,000.00	
	$900.00	
Minus: Accumulated OID ($4.17 × 188 months)	783.96	
Acquisition premium	$116.04	
3) Acquisition premium divided by number of complete and partial months from date of purchase to maturity date ($116.04 ÷ 52 months)		2.23
4) Line 1 minus line 3		$1.94

You must include $21.34 ($1.94 × 11 months) in income for 1998 because the acquisition premium reduces the ratable monthly portion of OID.

Example 6. Assume the same facts as *Example 5,* except that you bought the bonds for $9,783.96. In this case, your cost equals the original issue price plus accumulated OID. Therefore, you did not pay an acquisition premium. For 1998, include $45.87 ($4.17 × 11 months) of OID in income.

Example 7. Assume the same facts as *Example 5,* except that you bought the bonds for $9,400. In this case, you must include $45.87 of OID in your 1998 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. You do 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 obtain the instrument and ends the day before you dispose of it.

Example 8. On June 1, 1982, Ace Corporation issued a bond for $9,280, redeemable in 15 years at a stated redemption price of $10,000. The total OID is $720. The ratable monthly portion is $4, which is computed by dividing $720 by 180 months. You bought the bond on September 14, 1997, for $10,014 ($9,280 issue price plus $734 accumulated OID). You sold it on March 14, 1998. You figure the OID to include in your 1997 income as follows:

Amount for September ($4 × 17 days ÷ 30 days)	$2
Amount for complete months October through December ($4 × 3 months)	12
Total to include in 1997 income	$14

You figure the OID to include in your 1998 income as follows:

Amount for complete months January through February ($4 × 2 months)	$8
Amount for March ($4 × 13 days ÷ 31 days)	2
Total to include in 1998 income	$10

You increase your basis in the bond by the OID you include in income. Your basis in the bond when you sold it is $10,038 ($10,014 cost plus $14 OID for 1997 and $10 OID for 1998).

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.

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* and the discussions on acquisition premium that follow, later.

Form 1099–OID not received. If you held an OID instrument during the year 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 this figure 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 amount listed to figure your OID.

If you held the debt instrument the entire year, use the OID shown for calendar year 1998. If you did not hold the debt instrument the entire year, figure your OID using either of the following methods.

Method 1.
(This computation is an approximation and may result in a slightly higher amount of OID than Method 2.)

1) Divide the total OID for 1998 by 365.

2) Multiply the result in (1) by the number of days you held the debt instrument in 1998.

Method 2.

1) Look up the daily OID amount for the first 1998 accrual period you held the instrument. (See *Accrual period* under *Figuring OID,* next.)

2) Multiply the daily OID amount by the number of days in 1998 you held the instrument during that accrual period.

3) If you held the instrument for part of both 1998 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 1998, unless you paid an acquisition premium. (The reduction for acquisition premium is discussed later.)

If your instrument is not listed in *Section I–A,* consult the issuer for information about the issue price, yield to maturity, and the OID that accrued for 1998.

Figuring OID. This discussion shows how to figure OID on debt instruments issued after July 1, 1982, and before 1985, using a ***constant yield method*** (also known as the "exact" method). This method corresponds to the actual economic accrual of interest. 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."

Adjusted issue price. The adjusted issue price of a debt instrument at the beginning of the 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 of 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.

Yield to maturity (YTM). The yield to maturity 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 or tax advisor. 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.

Qualified stated interest (QSI). In general, qualified stated interest is stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) over the term of the instrument at a single fixed rate.

Accrual period. An accrual period for any OID instrument issued before 1985 is each one-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 overlap more than one accrual period.

Daily OID. The OID for any accrual period is allocated ratably to each day in the accrual period. You must include in income the sum of the OID amounts for each day that you hold the instrument during the year. If your tax year overlaps more than one accrual period, you must include the proper daily OID amounts for each of the two accrual periods.

The daily OID for the ***initial accrual period*** is computed using the following formula:

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

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 computed 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:

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

$$= \frac{\$102.83}{366} = \$.28096$$

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 1998.

Accrual Period	Year	Adjusted Issue Price	Daily OID	OID per Accrual 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

The daily OID for the sixteenth accrual period is figured as follows:

$$\frac{(\$94{,}718.95 \times 14.5587\%) - \$13{,}000}{365}$$

$$= \frac{\$789.85}{365} = \$2.16397$$

If you hold the bond for all of 1999, you would include $789.85 in income ($2.16397 × 365).

Example 10. Assume the same facts as *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). For each year from 1984 through 1997 you would have included the following OID amounts. If you continued to hold the bond, you would have included in income, for 1984 through 1997, 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
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

If you sold the bond on August 30, 1998, you would figure the amount to include in your 1998 income as follows:

First accrual period: $1.88896 × 120 days (Jan 1 – Apr 30)	$226.68
Second accrual period: $2.16397 × 121 days (May 1 – Aug 29)	261.84
Total to include in 1998 income	$488.52

However, if you held the bond the entire year of 1998, the total OID to report is $756.85 [$226.68 + $530.17 ($2.16397 × 245 days)].

Acquisition premium on debt instruments purchased before July 19, 1984. If you bought a debt instrument for more than its adjusted issue price but not more than its stated redemption price at maturity, the difference between your basis in the instrument and the adjusted issue price is acquisition premium. The acquisition premium reduces the OID to include in income over the period you hold the bond.

You reduce the daily OID by the daily acquisition premium. Figure this by dividing the 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 *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 as reduced for the acquisition premium for the accrual period May 1, 1984, to April 30, 1985, 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 divided by line 3		$.27341
5) Daily OID reduced for the acquisition premium. Line 1 minus line 4		$.04933

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

Assuming you still owned the bond in 1998, 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

If you held the bond all of 1998, reduce the total OID for that year, $756.85 (as determined in *Example 10),* by the allocable part of the acquisition premium for 1998, $99.79 ($.27341 × 365 days). The difference, $657.06, is the total OID to include in income for 1998.

Example 12. Assume the same facts as *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 *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 figured in *Example 12.* You do have market discount because your cost was less than the issue price plus the total OID that accrued before you acquired the bond. See *Market discount* under *Purchase after date of original issue* at the beginning of this section of the publication.

Acquisition premium on debt instruments purchased after July 18, 1984. If you purchased an OID instrument for more than its adjusted issue price but not more than its stated redemption price at maturity, the difference between your basis in the instrument and the adjusted issue price is acquisition premium. If you bought the debt instrument after July 18, 1984, the method of calculating the reduction of OID includible in income is different from the method described earlier in *Example 11.* Under this method, you multiply the daily OID by the following fraction to figure the amount that reduces the daily OID.

- 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 *Example 9,* except that you bought the bond for $95,000 on August 1, 1998, after its original issue on August 1, 1984. In this case, you paid more for the bond than its $94,029.48 adjusted issue price ($90,000 + $4,029.48 accrued OID). You paid $970.52 ($95,000 – $94,029.48) acquisition premium. The daily OID as reduced for the acquisition premium for the accrual period August 1, 1998, to July 31, 1999, is figured as follows:

1) Daily OID on date of purchase (15th accrual period)		$1.88896*
2) Acquisition premium	$970.52	
3) Total OID remaining after purchase date ($10,000 – $4,029.48)	5,970.52	
4) Line 2 divided by line 3		0.16255
5) Line 1 multiplied by line 4		0.30705
6) Daily OID reduced for the acquisition premium. Line 1 minus line 5		$1.58191

(* As shown in *Example 9.*)

The total OID to include in income for 1998 (August 1 - December 31) is $242.03 ($1.58191 × 153 days).

If you held the bond for all of 1999, reduce the OID for that year ($731.55) by $118.91 ($731.55 × 0.16255). The difference, $612.64, is the total OID to include in income for 1999.

Note. If you bought your corporate debt instrument in 1998 or 1999 and it is listed in *Section I–A,* you can compute the accumulated OID to the date of purchase by adding the following amounts.

1) The amount from the “Total OID to January 1, 1998” column for your debt instrument.
2) The OID from January 1, 1998, to the date of purchase, figured as follows.
   a) Multiply the daily OID for the first accrual period in 1998 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.

You should receive a Form 1099–OID showing OID for the part of 1998 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* and *Acquisition premium,* later.

You may also need to refigure the OID for a contingent payment or inflation-indexed debt instrument 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 had OID for 1998 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 this figure 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 amount listed to figure your OID.

Use the OID shown for the calendar year if you held the instrument the entire year. If you did not hold the debt instrument the entire year, figure your OID as follows.

1) Look up the daily OID amount for the first 1998 accrual period in which you held the instrument. (See *Accrual period* under *Figuring OID,* later.)
2) Multiply the daily OID amount by the number of days in 1998 you held the instrument during that accrual period.
3) Repeat (1) and (2) for any remaining 1998 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 1998 unless you paid an acquisition premium. (The reduction for acquisition premium is discussed later.)

If your instrument is not listed in *Section I–B,* consult the issuer for information about the issue price, yield to maturity, and the OID that accrued for 1998.

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. This discussion shows how to figure OID on debt instruments issued after 1984 using a ***constant yield method,*** also known as the "exact" method. (The special rules that apply to contingent payment debt instruments and inflation-indexed debt instruments are explained later.) This method corresponds to the actual economic accrual of interest. 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."

Adjusted issue price. The adjusted issue price of a debt instrument at the beginning of the 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 of 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.

Yield to maturity (YTM). The yield to maturity 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 or tax advisor. In general, the YTM is the discount rate that, when used in computing the present value of all principal and interest payments, produces an amount equal to the issue price.

Qualified stated interest (QSI). In general, qualified stated interest is stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) over the term of the instrument at a single fixed rate.

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 one 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 ratably to each day in the accrual period. Figure the amount to include in income by adding the daily OID amounts for each day that you hold the debt instrument during the year. Since your tax year will usually overlap more than one accrual period, you must include the proper daily OID amounts for each accrual period that falls within or overlaps your tax year. 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.

The daily OID is determined by dividing the OID for the accrual period by the number of days in the period.

Expressed as a formula, the daily OID for the ***initial accrual period*** is computed as follows:

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

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

The daily OID for ***subsequent accrual periods*** is computed the same way except that 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, 1998, 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, 2012, at a stated redemption price of $100,000. The yield to maturity is 12%, compounded semiannually. 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:

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

Since the first and second accrual periods coincide exactly with your tax year, you include in income for 1998 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 1998.

Example 16. Assume the same facts as *Example 15,* except that you bought the bond at original issue on May 1, 1998. 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, 1998 — October 31, 1998) 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, 1998 — April 30, 1999) is:

$$\frac{(\$86{,}409.28 \times .12/2) - \$5{,}000}{181 \text{ days}}$$
$$= \frac{\$184.56}{181} = \$1.01965$$

If you hold the bond through the end of 1998, you must include $236.31 of OID in income, $174.11 ($.94625 × 184 days) plus $62.20 ($1.01965 × 61 days). The OID is added to the $5,000 interest income paid on October 31, 1998. Your basis in the bond is increased by the OID you include in income. On January 1, 1999, 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, compute the daily OID as described earlier, but adjust the yield for the length of the short accrual period. You may use any reasonable compounding assumption 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 excess of the amount payable at maturity (other than a payment of qualified stated interest) over the adjusted issue price (issue price plus accumulated OID) at the beginning of the final accrual period.

Acquisition premium. If you bought a debt instrument for more than its adjusted issue price but not more than its stated redemption price at maturity, the difference between your basis in the instrument and the adjusted issue price is acquisition premium. The acquisition premium reduces the OID you include in income over the remaining life of the bond. Multiply the daily OID by the following fraction to figure the amount that reduces the daily OID.

- 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 *Example 16,* except that you bought the bond on November 1, 1998, for $87,000, after its original issue on May 1, 1998. The adjusted issue price on November 1, 1998, is $86,409.28 ($86,235.17 + $174.11). Under these assumptions, you purchased the bond at an acquisition premium of $590.72 (your cost, $87,000, less the adjusted issue price,

$86,409.28) and you must reduce the daily OID for any day you hold the bond.

The daily OID, as reduced for the acquisition premium, for the accrual period November 1, 1998, to April 30, 1999, is figured as follows:

1)	Daily OID on date of purchase (2nd accrual period)		$1.01965*
2)	Acquisition premium	$590.72	
3)	Total OID remaining after purchase date ($13,764.83 – $174.11)	13,590.72	
4)	Line 2 divided by line 3		0.04346
5)	Line 1 multiplied by line 4		0.04431
6)	Daily OID reduced for the acquisition premium. Line 1 minus line 5		$0.97534

(* As shown in *Example 16*.)

The total OID to include in income for 1998 is $59.50 ($.97534 × 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 noncontigent 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 the amount of 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 amount of a 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 amount of a contingent payment is greater than the projected fixed amount, you have a positive adjustment. If the amount of 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 exceeds the total of any positive adjustments. Use a net negative adjustment to offset OID on the debt instrument for the tax year. If the amount of the net negative adjustment exceeds the OID on the debt instrument for the tax year, you can claim the excess as an ordinary loss. However, the amount you can claim as an ordinary loss is limited to the amount of OID on the debt instrument you included in income in prior tax years. You must carry forward any excess net negative adjustment 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 amount of OID included in income. Your basis, however, is not affected by any negative or positive adjustments. Decrease your basis by the amount of any noncontigent payment received and the projected amount of any 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 your loss exceeds your prior OID accruals and the instrument is a capital asset, treat the excess loss as a capital loss.

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

Premium, acquisition, 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 product of the following.

- The instrument's outstanding principal amount (determined as if there were no inflation or deflation over the term of the instrument), multiplied by
- The index ratio for that date.

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 World Wide Web at: **www.publicdebt.ustreas.gov**

Form 1099–OID. The amount shown in box 1 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 1 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. The OID on an inflation-indexed debt instrument is figured using one of two methods.

- The ***coupon bond method,*** described in the following discussion, applies if the instrument is issued at par and all stated interest payable on the instrument is qualified stated interest. This method applies, for example, to any Treasury Inflation-Indexed Security.
- The ***discount bond method*** applies to any inflation-indexed debt instrument that does not qualify for the coupon bond method. This method is described in section 1.1275–7T(e) of the regulations.

Under the coupon bond method, figure the amount of 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, your OID for the year is:

1) The inflation-adjusted principal amount for the first day on which you held the instrument during the tax year, minus
2) The total of the following amounts.
   a) The inflation-adjusted principal amount for the day after the last day of the tax year.
   b) Any principal payments you received during the 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, your OID for the year is:

1) The inflation-adjusted principal amount for the first day on which you held the instrument during the tax year, minus
2) The total of the following amounts.
   a) The inflation-adjusted principal amount for the last day on which you held the instrument during the tax year.
   b) Any principal payments you received during the year.

Example 18. On February 6, 1998, 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, 1998, is $10,010.40. You held the debt instrument until September 1, 1998, when the inflation-adjusted principal amount was $10,116.50. Your OID for the 1998 tax year is $106.10 ($10,116.50 − $10,010.40). Your basis in the debt instrument on September 1, 1998, was $9,937.10 ($9,831 cost plus $106.10 OID for 1998).

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. This offset is shown as an adjustment on your Schedule B, in the same manner as that used to show an OID adjustment. See *How To Report OID,* earlier.

You decrease your basis in the debt instrument by the amount of 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, 1998, when the inflation-adjusted principal amount was $10,111.40, and sold the instrument on August 1, 1998, when the inflation-adjusted principal amount was $10,105.10. Because the OID calculation for 1998 ($10,105.10 minus $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, 1998, is $9,824.70 ($9,831 cost minus $6.30 deflation adjustment for 1998).

Premiums on inflation-indexed debt instruments. In general, the amount of any premium on an inflation-indexed debt instrument is determined, as of the date you acquire the instrument, by assuming that 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 there is any excess allocable to the year, this excess 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 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. They also include 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 that 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 the OID. If you keep the coupons, treat the excess of the amount payable on the coupons over the basis of the coupons as the 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 1 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.
2) The YTM of the stripped bond or coupon.

If you can establish the YTM of the bond (with all coupons attached) at the time of its original issue, you may use that YTM instead of the coupon rate in (1) above.

Increase your basis in the stripped tax-exempt bond or coupon by the interest that accrued but was not paid, and was not 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.

2) The YTM based on the purchase price of the stripped coupon or bond.

You can choose to use the original YTM instead of the coupon rate of the bond in (1) above.

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 excess of the OID determined in *Step 1* over 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 in 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, 2000, and a coupon rate of 10% (compounded semiannually) was issued for $100 on January 1, 1997. On January 1, 1998, 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, 1998, 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, 1998, is $4.75 (6% of $79.21). Of this, $4.11 (5% of $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 plus 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 1998, you must compute the OID to be included in income using a ***constant yield method*** that corresponds to the actual economic accrual of interest. 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 includible in income before that accrual period.

Accrual period. An accrual period for any stripped bond or coupon acquired before 1985 is each one-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 yield to maturity of a stripped bond or coupon is the discount rate that, when used in computing the present value of all principal and interest payments, produces an amount equal to the acquisition price.

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 one-year periods without including a shorter period, then the YTM can be computed by applying the following formula:

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

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 one-year periods, so that a period shorter than one 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, 1999. There are exactly 15 one-year periods between the purchase date, November 15, 1984, and the coupon's due date, November 14, 1999. Your YTM on this stripped coupon is figured as follows:

$$\left(\frac{\$100{,}000}{\$20{,}000}\right)^{1/15} - 1$$

$$= (1.11326 - 1) = 0.11326 = 11.326\%$$

Use 11.326% 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 ratably to each day in the accrual period. You figure the amount to include in income by adding the daily OID amounts for each day that you hold the debt instrument during the year. If your tax year overlaps 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 computed by applying the following formula:

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

ap = acquisition price
ytm = yield to maturity
p = number of days in accrual period

The daily OID for ***subsequent accrual periods*** is computed in the same way except that 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 after 1984, and you held that debt instrument during any part of 1998, you must compute the OID to be included in income using a ***constant yield method*** that corresponds to the actual economic accrual of interest. 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.

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 one year and all payments are made on the first or last day of an accrual period.

Yield to maturity (YTM). In general, the yield to maturity of a stripped bond or coupon is the discount rate that, when used in computing 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, then 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 one 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, 1987, 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, 1999. There are exactly twenty-five 6-month periods between the purchase date, May 15, 1987, and the coupon's due date, November 14, 1999. The YTM on this stripped coupon is figured as follows.

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

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***):

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

n = number of accrual periods in one 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 2, 1998, you bought a coupon stripped from a U.S. Treasury bond through the Department of the Treasury's STRIPS program for $60,000. An amount of $100,000 is payable on the coupon's due date, August 14, 2004. You decide to figure OID using 6-month accrual periods. There are twelve 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.

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

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 ratably 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 overlap more than one accrual period, you must include the proper daily OID amounts for each accrual period that falls within or overlaps your tax year.

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), except use the adjusted acquisition price in the formula instead of the acquisition price.

Formula 1 —

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

Formula 2 —

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

ap = acquisition price
ytm = yield to maturity
n = number of accrual periods in one 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

Example 24. Assume the same facts as *Example 23* and you held the coupon for the rest of 1998. The daily OID amounts are figured as follows:

For the short initial accrual period (using *Formula 2),* the daily OID equals:

$$\frac{\$60{,}000 \times (1 + .08406/2)^{\frac{74}{181}} - \$60{,}000}{74}$$

$$= \frac{\$1{,}018.48163}{74} = \$13.76327$$

For the second accrual period (using *Formula 1),* the daily OID equals:

$$\frac{\$61{,}018.48 \times (.08406/2)}{184}$$

$$= \frac{\$2{,}564.60671}{184} = \$13.93808$$

The adjusted acquisition price of $61,018.48 in this accrual period is the original $60,000 acquisition price plus $1,018.48 OID for the short initial accrual period (figured in step (1) of the following computation).

The OID to be reported on your 1998 tax return is figured as follows:

1) OID for first accrual period:
$13.76327 × 74 days
(June 2 – August 14) .... = $1,018.48

2) OID for second accrual period:
$13.93808 × 139 days
(August 15 – December 31) .... = 1,937.39

3) Total OID to report on 1998 tax return (line 1 plus line 2) $2,955.87

Note. 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.*

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

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Table 1. Explanation of Section I Column Headings

	1	2	3	4	5	6	7			8	
							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	Issue Price (Percent of Principal Amount	Annual Stated Interest Rate	Total OID to 1/1/98	1998 1st Period	1998 2nd & 1999 1st	1999 2nd Period	1998	1999
XYZ Corp.	123456AA	08/01/83	08/01/03	90.0	13.0	43.18	.018890	.021640	.024790	7.32	8.38

1. **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.
2. **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.
3. **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).
4. **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.
5. **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.
6. **Total OID to 1/1/98—**This shows the total OID accumulated on the debt instrument from the date of original issue to 1/1/98. (This information is not available for all instruments listed.)
7. **Daily OID in 1998 and 1999—**For corporate debt instruments issued after July 1, 1982, and before 1985, this is the OID for each day you held the debt instrument during the accrual periods falling in 1998 and 1999. (The daily OID for the second accrual period in 1998 and the first accrual period in 1999 are identical.) An accrual period is a one-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 1998 for XYZ bond is 8/1/97-7/31/98. The part of this accrual period that falls in 1998 is from 1/1/98-7/31/98. For each $1,000 principal amount of the bond, the OID is .018890 each day you held the bond during this accrual period. Similarly, the part of the second accrual period in 1998 is from 8/1/98-12/31/98. The OID is .021640 for each day you held the bond during this accrual period. The OID for each day you held a debt instrument in 1999 is determined in the same manner, using the daily OID applicable to the part of each accrual period falling in 1999. 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 1998 and 1999. The 1998 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 cross over into the next calendar year.
8. **OID for 1998 and 1999 (Per $1,000 of Maturity Value)—**The amount appearing in the 1998 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 1998, the amount is computed to the date of call or maturity. In the above example, if you held XYZ bond for all of 1998, the OID is $7.32 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 1998. (See *Figuring OID,* earlier, for more detailed information.) Similarly, the amount appearing in 1999 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.