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Proposed regulations: Transition from interbank offered rates (IBORs) to other reference rates

The U.S. Treasury Department and IRS today released for publication in the Federal Register proposed regulations (REG-118784-18) as guidance concerning the tax consequences of the transition to the use of reference rates other than “interbank offered rates” (IBORs) in debt instruments and non-debt contracts.

The [proposed regulations](#) [PDF 355 KB] address a number of topics, several of which are briefly described below.

1001 events. The proposed regulations generally provide that, if the terms of a debt instrument are altered, or the terms of a non-debt contract (e.g., a derivative like an interest rate swap) are modified, to replace (or to provide a fallback to) an IBOR-referencing rate with a “qualified rate,” and if the modification does not substantially change the fair market value of the debt or non-debt contract, the modification does not cause a realization event under section 1001. The proposed regulations list various qualified rates and provide two safe harbors regarding the substantially-equivalent-fair-market-value requirement.

Legging-out of integrated transactions. The proposed regulations provide flexibility to avoid legging-out of synthetic debts under Treas. Reg. section 1.1275-6. For example, if a taxpayer integrates a USD-LIBOR debt with an interest rate swap to create a synthetic fixed-rate debt, the taxpayer does not leg-out of the integrated transaction if the terms of the debt are altered and the swap is modified to replace USD LIBOR with a qualified rate.

One-time payments. Under the proposed regulations, if a taxpayer makes a one-time payment when changing an IBOR rate to a qualified rate, the source and character of the one-time payment will be the same as the source and character that would otherwise apply to a payment made by the payor with respect to the debt or non-debt contract that is altered or modified. For example, a one-time payment made by a counterparty to an interest rate swap is treated as a payment with respect to the leg of the swap on which the counterparty making the one-time payment is obligated to perform. Accordingly, under Reg. section 1.863-7(b), the source of that one-time payment would likely be determined by reference to the residence of the recipient of the payment.

Other topics. The proposed regulations also address:

- Certain grandfathering rules, such as those in sections 163(f), 871(m) or 1471; a debt would not lose its grandfathered status because its IBOR rate was altered to a qualified rate.
- Original issue discount (OID) and qualified floating rates (QFRs). Special rules provide for determining the amount and accrual of OID in the case of a variable rate debt that provides both for interest at an IBOR-referencing QFR and for a fallback rate that is triggered when the IBOR becomes unavailable.
- REMICs. An interest in a REMIC retains its status as a regular interest despite certain alterations and contingencies.
- Interest expense of a foreign corporation. Because the election in Reg. section 1.882-5(d)(5)(ii)(B) only permits a foreign corporation that is a bank to elect a rate that references 30-day LIBOR, the election will not be available when LIBOR is phased out. To address this change, the proposed regulations amend the election to allow a foreign corporation that is a bank to compute interest expense attributable to excess U.S.-connected liabilities using a yearly average secured overnight financing rate (SOFR).

Proposed applicability dates and reliance on the proposed regulations. The proposed regulations generally provide for an applicability date of the date the proposed rules are published as final regulations. However, taxpayers can choose to apply the rules to alterations and modifications that occur before that date, provided that the taxpayer and its related parties consistently apply the rules before that date.

Taxpayers may also rely on the proposed regulations for any alteration of the terms of a debt instrument or modification of the terms of a non-debt contract that occurs before final regulations are published, provided that the taxpayer and its related parties consistently apply the rules of the proposed regulations before that date.

Comments requested. Treasury and IRS have requested comments on any other complications under any section of the Code or existing regulations that may arise from the replacement of an IBOR with a qualified rate.

In general, comments and requests for a public hearing are due by a date that is 45 days after the proposed regulations appear in the Federal Register (scheduled for October 9, 2019).

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