



# TaxNewsFlash

United States



No. 2020-483  
July 31, 2020

## Final regulations: Rule for swaps with significant nonperiodic payments

The IRS this week posted on its website final regulations under section 163(j) and various other Code sections. As part of that package, a final regulation under Reg. section 1.446-3 re-implements a rule for certain swaps—typically called “notional principal contracts” for tax purposes—with significant nonperiodic payments.

Read the [final regulations](#) [PDF 2.22 MB] (575 pages)

### Background

Before temporary regulations were issued in May 2015, Reg. section 1.446-3 contained a rule that treated a swap with a significant nonperiodic payment as two separate transactions: a loan and an on-market, level-payment swap (an “embedded loan rule”). That rule was eliminated with the temporary regulations. See T.D. 9719 (80 FR 26437) (May 8, 2015) (as corrected by 80 FR 61308 (October 13, 2015)).

When the temporary regulations expired with no final regulations, the remaining regulations no longer contained an embedded loan rule.

The 2018 proposed regulations under section 163(j) would have treated the interest component of an embedded loan for a swap with a significant nonperiodic payment as interest for purposes of section 163(j). That rule has been implemented with the final section 163(j) regulations.

### Final rule

Released by the IRS earlier this week, the final regulations provide a general embedded loan rule for swaps with significant nonperiodic payments. See Reg. section 1.446-3(g)(4).

The final regulation contains two exceptions to the general rule.

- One exception is for a swap cleared by a registered derivatives clearing organization or a registered clearing agency, and such organization or agency requires the parties to the swap to post and collect margin or collateral.
- The other exception is for a non-cleared swap that requires the parties to meet the margin or collateral requirements of a federal regulator or that provides for margin or collateral requirements that are substantially similar to a cleared swap or a non-cleared swap subject to the margin or collateral requirements of a federal regulator.

The final regulations have an effective date of one year after their publication in the Federal Register, although taxpayers may rely on them in earlier years if applied consistently.

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