

**MEMO# 33006**

December 22, 2020

# IRS Issues Final Regulations Under Section 451(b) on Recognition of Income

[33006]

December 22, 2020 TO: ICI Members

Tax Committee SUBJECTS: Tax RE: IRS Issues Final Regulations Under Section 451(b) on Recognition of Income

The Internal Revenue Service (IRS) and the Treasury Department have finalized [regulations](#) under section 451(b) regarding the recognition of income. As requested by the Institute,[\[1\]](#) the final regulations clarify that section 451(b) does not apply to certain special methods of accounting, including the general timing rules for original issue discount (OID) and accrued market discount.[\[2\]](#)

Section 451(b), as amended by the 2017 tax legislation, generally requires taxpayers to include certain items into income for tax purposes no later than when they are included in revenue for financial accounting purposes.[\[3\]](#) The legislative history was clear that the changes were intended to override application of the OID rules to credit card and other fees that were treated as discount for tax purposes but as current income for financial reporting purposes. It was unclear, however, how these changes affected the accrual of market discount and OID on debt held by regulated investment companies (RICs) and other taxpayers.

The final regulations clarify that section 451(b) does not override certain special methods of accounting expressly permitted or required under the Internal Revenue Code, the regulations thereunder, or other IRS guidance. This includes:

- Methods of accounting for notional principal contracts under Treas. Reg. § 1.446-3;
- Methods of accounting for hedging transactions under Treas. Reg. § 1.446-4;
- Methods of accounting for gain on shares in a money market fund under Treas. Reg. § 1.446-7 (the NAV method);
- The mark-to-market method of accounting under section 475;
- Timing rules for income and gain associated with a transaction that is integrated under Treas. Reg. § 1.988-5, and income and gain under the nonfunctional currency contingent payment debt instrument rules in Treas. Reg. § 1.988-6;

- Except as provided in Treas. Reg. § 1.451-3(k) (regarding certain credit card fees), timing rules for OID under sections 811(b)(3) or 1272, income under the contingent payment debt instrument rules in Treas. Reg. § 1.1275-4, income under the variable rate debt instrument rules in Treas. Reg. § 1.1275-5, income and gain associated with a transaction that is integrated under § 1.1275-6, and income under the inflation-indexed debt instrument rules in Treas. Reg. § 1.1275-7;
- Timing rules for de minimis OID under Treas. Reg. § 1.1273-1(d) and *de minimis* market discount as defined in section 1278(a)(2)(C);
- Timing rules for accrued market discount under sections 1276 and 1278(b);
- Timing rules for short-term obligations under sections 1281 through 1283;
- Timing rules for stripped bonds under section 1286; and
- Methods of accounting provided in sections 1502 and 1503 and the regulations thereunder, including the method of accounting related to intercompany transactions under Treas. Reg. § 1.1502-13.

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#### endnotes

[1] See Institute Memorandum No. 31195, dated May 4, 2018, which can be found at: [https://www.ici.org/my\\_ici/memorandum/memo31195](https://www.ici.org/my_ici/memorandum/memo31195).

[2] The IRS and Treasury Department issued proposed regulations under section 451(b) in 2019. See Institute Memorandum No. 31949, dated September 6, 2019, which can be found at: [https://www.ici.org/my\\_ici/memorandum/memo31949](https://www.ici.org/my_ici/memorandum/memo31949).

[3] See Institute Memorandum No. 30991, dated December 21, 2017, which can be found at: [https://www.ici.org/my\\_ici/memorandum/memo30991](https://www.ici.org/my_ici/memorandum/memo30991).