Part III

Administrative, Procedural, and Miscellaneous

Proposed Method of Accounting for OID on a Pool of Credit Card Receivables

Notice 2011-99

Purpose

This notice provides a proposed revenue procedure in which the Internal Revenue Service ("IRS") will allow a taxpayer to use a simplified method of accounting to allocate original issue discount ("OID") on a pool of credit card receivables to an accrual period. The method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity ("principal") of the pool that is paid by cardholders during the period. The method is intended to reduce administrative burdens and controversy for taxpayers and the IRS in computing OID accruals on a pool of credit card receivables under § 1272(a)(6) of the Internal Revenue Code. This notice also requests comments on the proposed revenue procedure.

Request for Comments

      The Treasury Department and the IRS request comments on all aspects of the proposed revenue procedure in this notice. Consideration will be given to any written public comments that are submitted on or before March 16, 2012. A signed original and eight (8) copies of public comments should be sent by mail to the IRS at CC:PA:LPD:PR (IRS Notice 2011-99), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Public comments also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attn: CC:PA:LPD:PR (IRS Notice 2011-99). Comments also may be transmitted electronically via the following e-mail address: Notice.Comments@irscounsel.treas.gov. Please include "Notice 2011-99" in the subject line of any electronic communications. All comments will be available for public inspection and copying.

Drafting Information

      The principal author of this notice is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Charles W. Culmer on (202) 622-3950 (not a toll-free call).

PROPOSED REVENUE PROCEDURE

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations.
(Also Part I, § 1272(a)(6))

Rev. Proc. [XXXX-XX]

SECTION 1. PURPOSE

This revenue procedure allows a taxpayer to use a safe harbor method of

accounting for original issue discount ("OID") on a pool of credit card receivables for

purposes of § 1272(a)(6) of the Internal Revenue Code—the "proportional method."

The proportional method generally allocates to an accrual period an amount of

unaccrued OID that is proportional to the amount of the stated redemption price at

maturity ("principal") of the pool that is paid by cardholders during the period. Under

certain assumptions, the proportional method as described in this revenue procedure

generally produces the same results as an implementation of the method described in

§ 1272(a)(6). The revenue procedure also describes the exclusive procedures by which

a taxpayer may obtain the Commissioner's consent to change to the proportional

method.

SECTION 2. BACKGROUND

.01 A debt instrument is issued with OID if the instrument's issue price is less than its stated redemption price at maturity. Section 1273(a)(1). Under § 1.1273-1(b) of the Income Tax Regulations, the stated redemption price at maturity of a debt instrument is the sum of all payments provided by the debt instrument other than payments of qualified stated interest.   In general, qualified stated interest is stated interest that is unconditionally payable in cash, or that is constructively received under § 451, at least annually at a single fixed rate. Section 1.1273-1(c).

.02 Accruals of OID generally are taken into account over the term of a debt instrument using the constant yield method. See § 1272(a)(3) and § 1.1272-1. The Code provides special rules, however, for certain debt instruments for which the principal is subject to acceleration. See § 1272(a)(6). Under § 1272(a)(6), if the principal on a debt instrument is subject to acceleration, OID accruals are determined based on a prepayment assumption and a formula involving the present value of all remaining payments under the debt instrument as of the close of the accrual period, payments during the accrual period of amounts included in the stated redemption price at maturity of the debt instrument, and the adjusted issue price of the debt instrument at the beginning of the accrual period ("statutory method").

.03 The Taxpayer Relief Act of 1997 extended the rules of § 1272(a)(6) to OID on any pool of debt instruments the yield on which may be affected by reason of prepayments, including a pool of credit card receivables. See Pub. L. 105-34, § 1004(a), 1997-4 C.B. 1, 125. However, unlike the debt instruments previously subject

to § 1272(a)(6), the balance of a pool of credit card receivables can be increased, as well as decreased, from one accrual period to the next, which adds complexity in applying the rules of § 1272(a)(6).

.04 The Internal Revenue Service ("IRS") has challenged the methods of accounting for OID on pools of credit card receivables adopted by some taxpayers as not clearly reflecting income. See, for example, Capital One Financial Corp. v. Commissioner, 133 T.C. 136 (2009) (holding, in relevant part, that the model used by the taxpayer for computing OID accruals under § 1272(a)(6) was a reasonable method after some modifications by the court).

.05 The proportional method as described in this revenue procedure is intended to reduce administrative burdens and controversy for taxpayers and the IRS in computing OID accruals on a pool of credit card receivables under § 1272(a)(6). Under certain assumptions, the proportional method is a simplified method of calculation that generally produces the same results as an implementation of the statutory method.

.06 Certain credit card fees are treated as creating or increasing the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Proc. 2004-33, 2004-1 C.B. 989 (Commissioner will allow a taxpayer to treat late fees as OID). However, certain fees do not create or increase the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Rul. 2004-52, 2004-1 C.B. 973 (credit card annual fees do not result in OID).

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer issues credit cards allowing cardholders to access a revolving line of credit established by the taxpayer to purchase goods and services, or to obtain cash advances;

.02 For federal income tax purposes, the taxpayer does not treat the credit card purchase transactions of its cardholders as creating debt that is given in consideration for the sale or exchange of property;

.03 The taxpayer maintains one or more pools of receivables with respect to such credit cards; and

.04 In the case of a taxpayer that maintains more than one pool of credit card receivables, the manner in which pools are established and maintained does not achieve a result that is unreasonable in light of the purposes of §§ 1271 through 1275.

SECTION 4. APPLICATION

.01 The proportional method of accounting described in section 5 of this revenue procedure is a permissible method for use by a taxpayer within the scope of this revenue procedure to account for OID on a pool of credit card receivables described in section 3 of this revenue procedure. If the proportional method is used by a taxpayer to account for any pool of credit card receivables, the method must be used for every pool of credit card receivables described in section 3 of this revenue procedure and held by that taxpayer. If the proportional method is used for more than one such pool, separate data for each pool must be kept, and the computations must be made separately based on the data for each pool.

.02 A taxpayer that wants to change its method of accounting to the proportional

method must use the automatic change in method procedures of Rev. Proc. 2011-14, 2011-4 I.R.B. 330, or its successor, to make the change. See section 8 of this revenue procedure. If a taxpayer changes to the proportional method, the unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the receivables in the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the receivables. See section 5.02(2) of this revenue procedure. If a taxpayer does not already have a method of accounting for OID on any pool of credit card receivables, the taxpayer may adopt the proportional method by using it on a timely-filed federal income tax return for the first taxable year the taxpayer must account for OID on a pool of credit card receivables. A taxpayer may use the proportional method for the taxpayer's first taxable year that begins on or after the effective date described in section 7 of this revenue procedure.

SECTION 5. PROPORTIONAL METHOD OF ACCOUNTING

This section 5 describes the proportional method of accounting for OID on a pool of credit card receivables. Under the method—

.01 The required computations must be made monthly. Thus, the computation period referred to below is a calendar month (or that portion of a month that falls within a short taxable year). A taxpayer that changes its method of accounting to the proportional method must make the required computations for each month in the year of change by the due date for the taxpayer's timely filed (including any extension) original federal income tax return implementing the change in method of accounting for the year of change.

.02 At the beginning of each computation period, the taxpayer must determine the following information for each pool of credit card receivables:

(1) The stated redemption price at maturity as of the beginning of the period ("Beginning SRPM"), which is equal to the aggregate balance owed on all credit card receivables included in the pool at the beginning of such period, other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest).

(2) The unaccrued OID as of the beginning of the period ("Beginning OID"), which is equal to the OID with respect to the credit card receivables included in the pool at the beginning of such period that has not previously been taken into income.

.03 During each computation period, the taxpayer must determine for each pool of credit card receivables the sum of the payments during the period of amounts that reduce the Beginning SRPM for the period ("SRPM Payments") (equivalently, total payments less amounts that are not included in SRPM, such as charges or fees that are not properly treated as OID).

.04 For each computation period, the taxpayer must compute the OID allocated to the period ("Monthly OID") and include this amount in income for the period. Monthly OID is the product of (1) the Beginning OID multiplied by (2) the quotient of the SRPM Payments divided by the Beginning SRPM.

.05 The formula in section 5.04 of this revenue procedure can be restated as follows:

$$M\_OID = BEG\_OID * (SRPM\_P / BEG\_SRPM),$$

where

M_OID = Monthly OID;

BEG_OID = Beginning OID;

SRPM_P = SRPM Payments;

BEG_SRPM = Beginning SRPM.

.06 For purposes of determining the Beginning SRPM and Beginning OID for a period, the taxpayer should take into account the following items:

(1) The charges and fees relating to the pool for the preceding period that are properly treated as OID;

(2) Credit card accounts transferred into the pool from another one of the taxpayer's pools during the preceding period, including any unaccrued OID attributable to the accounts;

(3) Credit card accounts transferred out of the pool into another one of the taxpayer's pools during the preceding period, including any unaccrued OID attributable to the accounts; and

(4) Credit card accounts written off during the preceding period, including any unaccrued OID attributable to the accounts.

.07 Section 1.6001-1(a) of the Procedure and Administration Regulations provides that any person subject to tax under subtitle A of the Internal Revenue Code shall keep such permanent books of account or records to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax. In order to satisfy the recordkeeping requirements of

§ 6001 and the regulations thereunder, a taxpayer that uses the proportional method of accounting should maintain records supporting all aspects of its method, including, but not limited to, the computations described in section 5 of this revenue procedure.

SECTION 6. EXAMPLES

.01 Example 1. (1) On December 1, for the taxpayer's single pool of credit card receivables, the Beginning SRPM is $100,000,000, and the Beginning OID is $1,000,000. During December, the taxpayer receives SRPM payments of $11,000,000 with respect to the pool.

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of $110,000 ($1,000,000 * ($11,000,000 / $100,000,000)).

.02 Example 2. (1) The facts are the same as in Example 1 except that, during November, additional transactions occur that affect the Beginning SRPM and Beginning OID for December. During November, cardholders incur additional fees of $100,000 that are properly treated as OID, and the taxpayer writes off additional credit card accounts whose aggregate balance at the time of the write-offs is $50,000. The taxpayer determines that the unaccrued OID attributable to the additional written-off accounts is $1,000. As a result, on December 1, the Beginning SRPM is $100,050,000 ($100,000,000 + $100,000 - $50,000), and the Beginning OID is $1,099,000 ($1,000,000 + $100,000 - $1,000).

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of $120,830 ($1,099,000 * ($11,000,000 / $100,050,000)).

SECTION 7. EFFECTIVE DATE

[RESERVED]

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011-14 is modified to add new section 31.02 to the APPENDIX, to read as follows:

SECTION 31.02. Proportional method of accounting for OID on a pool of credit card receivables

(1) <u>Description of change</u>. This change applies to a taxpayer that wants to change to the proportional method of accounting for OID on a pool of credit card receivables as described in Rev. Proc. xxxx-xx. Under Rev. Proc. xxxx-xx, a taxpayer may use the proportional method of accounting for the taxpayer's first taxable year that begins on or after the effective date described in section 7 of Rev. Proc. xxxx-xx.

(2) <u>Manner of making change</u>. This change is made on a cut-off basis. Accordingly, a § 481(a) adjustment is neither required nor permitted. The unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the receivables in the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the receivables. See section 2.06 of this revenue procedure for more information regarding a cut-off basis.

(3) <u>Designated automatic accounting method change number</u>. The designated automatic accounting method change number for a change under section 31.02 of this APPENDIX is "XXX." See section 6.02(4) of this revenue procedure.

(4) <u>Contact information</u>. For further information regarding this section, please

contact Charles W. Culmer at (202) 622-3950 (not a toll-free call).

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Charles W. Culmer on (202) 622-3950 (not a toll free call).