

Reg. Section 1.263(a)-4(d)(2)

Amounts paid to acquire or create intangibles.

(d) Created intangibles –

(1) In general. Except as provided in paragraph (f) of this section (relating to the 12-month rule), a taxpayer must capitalize amounts paid to create an intangible described in this paragraph (d). The determination of whether an amount is paid to create an intangible described in this paragraph (d) is to be made based on all of the facts and circumstances, disregarding distinctions between the labels used in this paragraph (d) to describe the intangible and the labels used by the taxpayer and other parties to the transaction.



(2) Financial interests –

(i) In general. A taxpayer must capitalize amounts paid to another party to create, originate, enter into, renew or renegotiate with that party any of the following financial interests, whether or not the interest is regularly traded on an established market:

(A) An ownership interest in a corporation, partnership, trust, estate, limited liability company, or other entity.

(B) A debt instrument, deposit, stripped bond, stripped coupon (including a servicing right treated for federal income tax purposes as a stripped coupon), regular interest in a REMIC or FASIT, or any other intangible treated as debt for Federal income tax purposes.

(C) A financial instrument, such as –

(1) A letter of credit;

(2) A credit card agreement;

(3) A notional principal contract;

(4) A foreign currency contract;

(5) A futures contract;

(6) A forward contract (including an agreement under which the taxpayer has the right and obligation to provide or to acquire property (or to be compensated

for such property, regardless of whether the taxpayer provides or acquires the property));

(7) An option (including an agreement under which the taxpayer has the right to provide or to acquire property (or to be compensated for such property, regardless of whether the taxpayer provides or acquires the property)); and

(8) Any other financial derivative.

(D) An endowment contract, annuity contract, or insurance contract that has or may have cash value.

(E) Non-functional currency.

(F) An agreement providing either party the right to use, possess or sell a financial interest described in this paragraph (d)(2).

(ii) Amounts paid to create, originate, enter into, renew or renegotiate. An amount paid to another party is not paid to create, originate, enter into, renew or renegotiate a financial interest with that party if the payment is made with the mere hope or expectation of developing or maintaining a business relationship with that party and is not contingent on the origination, renewal or renegotiation of a financial interest with that party.

(iii) Renegotiate. A taxpayer is treated as renegotiating a financial interest if the terms of the financial interest are modified. A taxpayer also is treated as renegotiating a financial interest if the taxpayer enters into a new financial interest with the same party (or substantially the same parties) to a terminated financial interest, the taxpayer could not cancel the terminated financial interest without the consent of the other party (or parties), and the other party (or parties) would not have consented to the cancellation unless the taxpayer entered into the new financial interest. A taxpayer is treated as unable to cancel a financial interest without the consent of the other party (or parties) if, under the terms of the financial interest, the taxpayer is subject to a termination penalty and the other party (or parties) to the financial interest modifies the terms of the penalty.

(iv) Coordination with other provisions of this paragraph (d). An amount described in this paragraph (d)(2) that is also described elsewhere in paragraph (d) of this section is treated as described only in this paragraph (d)(2).

(v) Coordination with § 1.263(a)-5. See § 1.263(a)-5 for the treatment of borrowing costs and the treatment of amounts paid by an option writer.

(vi) Examples. The following examples illustrate the rules of this paragraph (d)(2):

Example 1. Loan. X corporation, a commercial bank, makes a loan to A in the principal amount of \$250,000. The \$250,000 principal amount of the loan paid to A constitutes an amount paid to another party to create a debt instrument with that party under paragraph (d)(2)(i)(B) of this section and must be capitalized.

Example 2. Option. W corporation owns all of the outstanding stock of X corporation. Y corporation pays W \$1,000,000 in exchange for W's grant of a 3-year call option to Y permitting Y to purchase all of the outstanding stock of X at a certain price per share. Y's payment of \$1,000,000 to W constitutes an amount paid to another party to create an option with that party under paragraph (d)(2)(i)(C)(7) of this section and must be capitalized.

Example 3. Partnership interest. Z corporation pays \$10,000 to P, a partnership, in exchange for an ownership interest in P. Z's payment of \$10,000 to P constitutes an amount paid to another party to create an ownership interest in a partnership with that party under paragraph (d)(2)(i)(A) of this section and must be capitalized.

Example 4. Take or pay contract. Q corporation, a producer of natural gas, pays \$1,000,000 to R during 2005 to induce R corporation to enter into a 5-year "take or pay" gas purchase contract. Under the contract, R is liable to pay for a specified minimum amount of gas, whether or not R takes such gas. Q's payment of \$1,000,000 is an amount paid to another party to induce that party to enter into an agreement providing Q the right and obligation to provide property or be compensated for such property (regardless of whether the property is provided) under paragraph (d)(2)(i)(C)(6) of this section and must be capitalized.

Example 5.. Agreement to provide property. P corporation pays R corporation \$1,000,000 in exchange for R's agreement to purchase 1,000 units of P's product at any time within the three succeeding calendar years. The agreement describes P's \$1,000,000 as a sales discount. P's \$1,000,000 payment is an amount paid to induce R to enter into an agreement providing P the right and obligation to provide property under paragraph (d)(2)(i)(C)(6) of this section and must be capitalized.

Example 6. Customer incentive payment. S corporation, a computer manufacturer, seeks to develop a business relationship with V corporation, a computer retailer. As an incentive to encourage V to purchase computers from S, S enters into an agreement with V under which S agrees that, if V purchases \$20,000,000 of computers from S within 3 years from the date of the agreement, S will pay V \$2,000,000 on the date that V reaches the \$20,000,000 threshold. V reaches the \$20,000,000 threshold during the third year of the agreement, and S pays V \$2,000,000. S is not required to capitalize its payment to V under this paragraph (d)(2) because the payment does not provide S the right or obligation to provide property and does not create a separate and distinct intangible asset for S within the meaning of paragraph (b)(3)(i) of this section.