
Internal Revenue Service

**Excise Tax – Obligations Not in Registered
Form D**

Audit Techniques Guide (ATG)

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The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in *Webster's Dictionary* or from a list of names of counties in the United States as listed in the *U.S. Government Printing Office Style Manual*.



Department of the Treasury
Internal Revenue Service



Internal
Revenue
Service

Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.



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Ten Core Ethical Principles *

Honesty
Integrity/Principled
Promise-Keeping
Loyalty
Fairness
Caring and Concern for Others
Respect for Others
Civic Duty
Pursuit of Excellence
Personal Responsibility/Accountability

The Five Principles of Public Service Ethics *

Public Interest
Objective Judgment
Accountability
Democratic Leadership
Respectability

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**Chapter 1 – Introduction and
The Securities Act of 1933**

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Introduction

IRC section 4701(a) imposes a tax on the principal amount of a bearer bond issued by any United States person. The tax was implemented by the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, §310(b)(4)(A). It applies to most public offered debt obligations issued after 1982 unless they are issued in registered form. The tax does not apply to obligations issued in bearer form pursuant to warrants or convertible bonds before August 10, 1982 if they are under arrangements reasonably designed to ensure that they will be sold or resold only to foreign persons.

The purpose of IRC Section 4701, along with its companion IRC Section 163(f), is to stop the issuance of bearer bonds to citizens and residents of the United States. While IRC Section 4701 imposes an excise tax as a penalty to the issuer of the bearer bond, IRC Section 163(f) disallows the deduction for the interest on the bearer bond. Since bearer bonds made it difficult to determine the recipient of the interest for tax purposes, IRC Sections 4701 and 163(f) were enacted to make it too expensive to issue bearer bonds.

Reported On:

This tax is reported on Form 720, Line 031.

Law:

Imposition of the tax - Internal Revenue Code Section 4701 imposes an excise tax on registration required obligations, as defined in Internal Revenue Code Section 163(f), which are issued in non-registered (bearer) form. The tax is imposed on any person who issues a registration-required obligation in bearer form. (IRC §4701(a)).

Computation of the tax - For such non-registered obligations issued after 12-31-82, the tax is computed by multiplying 1% against the principal amount of the bond, multiplied again by the number of years (or portions thereof) in the term of the obligations. (IRC §4701(a)(1) and IRC §4701(a)(2)).

Regulation Section 5f.103-1(c) defines the term registered form as follows:

(c) Registered form - (1) General rule. An obligation issued after January 20, 1987, is in registered form if -

- (i) the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and transfer of the obligation may be effected only by surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder,
- (ii) the obligation to the principal of and stated interest on, the obligation may be transferred only through a book entry system maintained by the issuer (or its agent) (as described in paragraph (c)(2) of this section), or
- (iii) the obligation is registered as to both the principal and any stated interest with the

issuer (or its agent) and may be transferred through both methods described in subdivisions (i) and (ii).

(2) Special rule for registration of a book entry obligation. An obligation shall be considered transferable through a book entry system if the ownership of an interest in the obligation is required to be reflected in a book entry, whether or not physical securities are issued. A book entry is a record of ownership that identifies the owner of an interest in the obligation.

Definitions:

Principal Amount - The term “principal amount” for a discounted obligation is the issue price, and for all other obligations, including obligations sold at a premium, the term “principal amount” is the stated redemption at maturity. (Treasury Regulation §46.4701-1(c)).

Registration-Required Obligation - Section 4701 (b)(1) provides that the term "registration-required obligation" has the same meaning as when used in Section 163(f), except that such term shall not include any obligations required to be registered under section 149(a). Section 163(f) provides that the term “registered-required obligation” means any obligation (including any obligation issued by a government entity) other than an obligation which -

- (i) is issued by a natural person,
- (ii) is not of a type offered to the public,
- (iii) has a maturity (at issue) of not more than 1 year, or
- (iv) an obligation is issued where there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and
- (v) in the case of an obligation not in registered form -
 - I. interest on such obligation is payable only outside the United States and its possessions, and
 - II. on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws. (Internal Revenue Code Section 163(f) (2)).

Obligation - The term “obligation” includes bonds, debentures, notes, certificates, and other evidence of indebtedness regardless of how denominated. (Treasury Regulation §46.4701-1(b)(2))

Issuer - the “issuer” is the person whose interest deduction would be disallowed solely by reason of 163(f) (1). (Treasury Regulation §46.4701-1(b) (5)).

Date of Issuance - for obligations intended to be offered to the public, the term “date of issuance” means the date the obligation is first sold to the public at the issuance price. For an obligation which is privately placed, the term “date of issuance” is the date the obligation is first sold by the issuer. (Treasury Regulation §46.4701-1(b) (6)).

Issue Price - For:

- a. Publicly offered debt instruments not issued for property - the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instrument was sold.
- b. Other debt instruments not issued for property and not publicly offered - the issue price of each such instrument is the price paid by the first buyer of such debt instrument.
- c. Debt instruments issued for property where there is public trading and which are part of an issue a portion of which is traded on an established securities market, or are issued for stock or securities which are traded on an established market, or to the extent provided in the regulations, are issued for property (other than stock or securities) of a kind regularly traded on an established market - the issue price of such debt instrument shall be the fair market value of such property. (Internal Revenue Code Section 1273(b) and Treasury Regulation §46.4701-1(b) (7)).

Bearer Bond - An unregistered, negotiable bond on which interest and principal are payable to the holder, regardless of whom it was originally issued to. The coupons are attached to the bond, and each coupon represents a single interest payment. The holder submits a coupon, usually semiannually, to the issuer or paying agent to receive payment.

Convertible Bond - A convertible bond is a bond which can be converted into the company's stock. You can exercise the convertible bond and exchange the bond into a predetermined number of shares in the company.

The Securities Act of 1933

The Securities Act of 1933 has two basic objectives:

- require that investors receive financial and other significant information concerning securities being offered for public sale; and
- prohibit deceit, misrepresentations, and other fraud in the sale of securities.

Purpose of Registration

A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors to make informed judgments about whether to purchase a company's securities.

The Registration Process

In general, securities sold in the U.S. must be registered. The registration forms companies file provide essential facts about the securities and the company issuing them. In general, registration forms call for:

- a description of the company’s properties and business;
- a description of the security to be offered for sale;
- information about the management of the company; and
- financial statements certified by independent accountants.

All companies, both domestic and foreign, must file their registration statements electronically. These statements and the accompanying prospectus become public shortly after filing, and investors can access them using EDGAR. Registration statements are subject to examination for compliance with disclosure requirements.

Not all offerings of securities must be registered with the Securities and Exchange Commission (the “SEC”). Some exemptions from the registration requirement include:

- private offerings to a limited number of persons or institutions;
- offerings of limited size;
- intrastate offerings; and
- securities of municipal, state, and federal governments.

Please note:

- When a company is required to register a public offering of a security with the SEC, it is registering the issuance of the security and not the owners of the security. This does not mean however, the issuance is or is not subject to tax. We must look to the issuer and determine whether the debt offering is in registered form per the excise tax regulations.
- Also, when a company does not have to register a security with the SEC, it does not automatically give rise to taxation. Again, we must look to the issuer and determine whether the debt offering is in registered form per the excise tax regulations.
- Registration of securities with the SEC and registered form per the excise tax regulations are two different concepts and must be viewed independently of each other.

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**Chapter 2 – Securities and Exchange Commission
(SEC) Form D Leads**

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Securities and Exchange Commission (SEC) FORM D Leads

All the information regarding regulation D offerings can be found at the U.S. Securities and Exchange Commission <http://www.sec.gov/answers/regd.htm> web site.

SEC Form D - Notice of Sale of Securities Pursuant to Regulation D

Under the Securities Act of 1933, any offer to sell securities must either be registered with the SEC or meet an exemption. Regulation D (or Reg D) provides three exemptions from the registration requirements, allowing some smaller companies to offer and sell their securities without having to register the securities with the SEC.

While companies using a Reg D exemption do not have to register their securities and usually do not have to file reports with the SEC, they must file what's known as a "Form D" after they first sell their securities. Form D is a brief notice that includes the names and addresses of the company's owners and stock promoters, but contains little information about the company.

There are three types of Reg D filings: Rule 504, Rule 505 and Rule 506 which are each discussed below. The lead in the case file contains one of the filings.

Rule 504

Rule 504 of Regulation D provides an exemption from the registration requirements of the federal securities laws for some companies when they offer and sell up to \$1,000,000 of their securities in any 12-month period.

A company can use this exemption as long as it is not a blank check company and does not have to file reports under the Securities Exchange Act of 1934. Also, the exemption generally does not allow companies to solicit or advertise their securities to the public and purchasers receive restricted securities, meaning they not sell the securities without registration or an applicable exemption.

Rule 504 does allow companies to make public offering of freely tradable securities but only if one of the following circumstances is met:

- The company registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors;
- A company registers and sells the offering in a state that requires registration and disclosure delivery and also sells in a state without those requirements, so long as the company delivers the disclosure documents required by the state where the company registered the offering to all purchasers (including those in the state that has no requirements); or
- The company sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as the company sells only to

accredited investors. Even if a company makes a private sale where there are no specific disclosure delivery requirements, a company should take care to provide sufficient information to investors to avoid violating the antifraud provisions of the securities laws. This means that any information a company provides to investors must be free from false or misleading statements. Similarly, a company should not exclude and information if the omission makes what is provided to investors false or misleading.

Rule 505

Rule 505 of Regulation D allows some companies offering their securities to have those securities exempted from the registration requirements of the securities laws. To qualify for this exemption, a company:

- Can only offer and sell up to \$5 million of its securities in any 12 month period;
- May sell to an unlimited number of accredited investors and up to 35 other persons who do not need to satisfy the sophistication or wealth standards associated with other exemptions;
- Must inform purchasers that they receive restricted securities, meaning that the securities cannot be sold for at least a year without registering them; and
- Cannot use general solicitation or advertising to sell the securities.

Rule 505 allows companies to decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws. But companies must give non-accredited investors disclosure documents that generally are the same as those used in registered offerings.

If a company provides information to accredited investors, it must make this information available to non-accredited investors as well. The company must also be available to answers questions by prospective purchasers.

Here are some specifics about the financial statement requirements applicable to this type of offering:

- Financial statements need to be certified by an independent public accountant;
- If a company other than limited partnership cannot obtain audited financial statements without unreasonable effort or expense, only the company's balance sheet (to be dated within 120 days of the start of the offering) must be audited; and
- Limited partnerships unable to obtain required financial statements without unreasonable effort or expense may furnish audited financial statements prepared under the federal income tax laws.

Rule 506

Rule 506 of Regulation D is considered a “safe harbor” for the private offering exemption of Section 4(2) of the Securities Act. Companies using the Rule 506 exemption can raise an unlimited amount of money. A company can be assured it is within the Section 4(2) exemption by satisfying the following standards:

- The company cannot use general solicitation or advertising to market the securities;
- The company may sell its securities to an unlimited number of accredited investors and up to 35 other purchasers. Unlike Rule 505, all non-accredited investors, either alone or with a purchaser representative, must be sophisticated – that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment;
- Companies must decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws. But companies must give non-accredited investors disclosure documents that generally are the same as those used in registered offerings. If a company provides information to accredited investors, it must make this information available to non-accredited investors as well. The company must also be available to answer questions by prospective purchasers.
- The company must be available to answer questions by prospective purchasers;
- Financial statement requirements are the same as for Rule 505; and
- Purchasers receive restricted securities, meaning that the securities cannot be sold for at least a year without registering them.

Records to Request

The deal package should contain a copy of all the obligations issued by the entity. A Deal Package should contain a Selling Group Agreement, an Offering Circular, a Paying Agent agreement (if applicable), copies of the Security or Specimen copies of the Security and a record of each owner of the obligation. The obligation, along with all related legal documentation for each issuance should be reviewed in detail, and a schedule of the obligations and possible problems causing taxability as Obligations not in Registered Form should be listed. If no record of ownership for each obligation issued is maintained, the obligation was issued in bearer form and the tax applies.

In summary,

In order for an obligation not in registered form issued in the United States to be subject to the Obligations not in Registered Form Excise Tax, it must be:

- a. issued by other than a natural person
- b. of a type offered to the public
- c. has a maturity (at issue) in excess of 1 year and
- d. not designed to meet the foreign debt targeting requirements of § 163(f)(2)(B).

Sources of Information

Internal Revenue Code § 4701
Treasury Regulation 46.4701-1
Internal Revenue Code § 163
Treasury Regulation 1.163
Internal Revenue Code § 149
Internal Revenue Code § 103
Treasury Regulation 5f.103.1

<http://www.investorwords.com>

Please contact Dennis Caranna, Excise Policy Analyst @ 601-292-4747 or dennis.caranna@irs.gov if you have any questions or need additional guidance.

References/Related Topics

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