



Tax Reduction Letter

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Internal Revenue Code Section 1274(d)

Determination of issue price in the case of certain debt instruments issued for property.

(a) In general. In the case of any debt instrument to which this section applies, for purposes of this subpart, the issue price shall be—

- (1) where there is adequate stated interest, the stated principal amount, or
- (2) in any other case, the imputed principal amount.

(b) Imputed principal amount. For purposes of this section—

(1) In general. Except as provided in paragraph (3), the imputed principal amount of any debt instrument shall be equal to the sum of the present values of all payments due under such debt instrument.

(2) Determination of present value. For purposes of paragraph (1), the present value of a payment shall be determined in the manner provided by regulations prescribed by the Secretary—

(A) as of the date of the sale or exchange, and

(B) by using a discount rate equal to the applicable Federal rate, compounded semiannually.

(3) Fair market value rule in potentially abusive situations.

(A) In general. In the case of any potentially abusive situation, the imputed principal amount of any debt instrument received in exchange for property shall be the fair market value of such property adjusted to take into account other consideration involved in the transaction.

(B) Potentially abusive situation defined. For purposes of subparagraph (A), the term "potentially abusive situation" means—

(i) a tax shelter (as defined in section 6662(d)(2)(C)(iii)), and

(ii) any other situation which, by reason of—

(I) recent sales transactions,

(II) nonrecourse financing,

(III) financing with a term in excess of the economic life of the property, or

(IV) other circumstances,

is of a type which the Secretary specifies by regulations as having potential for tax avoidance.

(c) Debt instruments to which section applies.

(1) In general. Except as otherwise provided in this subsection, this section shall apply to any debt instrument given in consideration for the sale or exchange of property if—

(A) the stated redemption price at maturity for such debt instrument exceeds—

(i) where there is adequate stated interest, the stated principal amount, or

(ii) in any other case, the imputed principal amount of such debt instrument determined under subsection (b), and

(B) some or all of the payments due under such debt instrument are due more than 6 months after the date of such sale or exchange.

(2) Adequate stated interest. For purposes of this section, there is adequate stated interest with respect to any debt instrument if the stated principal amount for such debt instrument is less than or equal to the imputed principal amount of such debt instrument determined under subsection (b).

(3) Exceptions. This section shall not apply to—

(A) Sales for \$ 1,000,000 or less of farms by individuals or small businesses.

(i) In general. Any debt instrument arising from the sale or exchange of a farm (within the meaning of section 6420(c)(2))—

(I) by an individual, estate, or testamentary trust,

(II) by a corporation which as of the date of the sale or exchange is a small business corporation (as defined in section 1244(c)(3)), or

(III) by a partnership which as of the date of the sale or exchange meets requirements similar to those of section 1244(c)(3).

(ii) \$ 1,000,000 limitation. Clause (i) shall apply only if it can be determined at the time of the sale or exchange that the sales price cannot exceed \$ 1,000,000. For purposes of the preceding sentence, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(B) Sales of principal residences. Any debt instrument arising from the sale or exchange by an individual of his principal residence (within the meaning of section 121).

(C) Sales involving total payments of \$ 250,000 or less.

(i) In general. Any debt instrument arising from the sale or exchange of property if the sum of the following amounts does not exceed \$ 250,000:

(I) the aggregate amount of the payments due under such debt instrument and all other debt instruments received as consideration for the sale or exchange, and

(II) the aggregate amount of any other consideration to be received for the sale or exchange.

(ii) Consideration other than debt instrument taken into account at fair market value.

For purposes of clause (i), any consideration (other than a debt instrument) shall be taken into account at its fair market value.

(iii) Aggregation of transactions. For purposes of this subparagraph, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(D) Debt instruments which are publicly traded or issued for publicly traded property.
Any debt instrument to which section 1273(b)(3) applies.

(E) Certain sales of patents. In the case of any transfer described in section 1235(a) (relating to sale or exchange of patents), any amount contingent on the productivity, use, or disposition of the property transferred.

(F) Sales or exchanges to which section 483(e) applies. Any debt instrument to the extent section 483(e) (relating to certain land transfers between related persons) applies to such instrument.

(4) Exception for assumptions. If any person—

(A) in connection with the sale or exchange of property, assumes any debt instrument, or

(B) acquires any property subject to any debt instrument, in determining whether this section or section 483 applies to such debt instrument, such assumption (or such acquisition) shall not be taken into account unless the terms and conditions of such debt instrument are modified (or the nature of the transaction is changed) in connection with the assumption (or acquisition).

→ (d) Determination of applicable Federal rate. For purposes of this section—

(1) Applicable Federal rate.

(A) In general.

In the case of a debt instrument with a term of:	The applicable Federal rate is:
Not over 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal med-term rate.
Over 9 years	The Federal long-term rate.

(B) Determination of rates. During each calendar month, the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

(C) Federal rate for any calendar month. For purposes of this paragraph—

- (i) Federal short-term rate. The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.
- (ii) Federal mid-term and long-term rates. The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

(D) Lower rate permitted in certain cases. The Secretary may by regulations permit a rate to be used with respect to any debt instrument which is lower than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such lower rate is based on the same principles as the applicable Federal rate and is appropriate for the term of such instrument.

(2) Lowest 3-month rate applicable to any sale or exchange.

(A) In general. In the case of any sale or exchange, the applicable Federal rate shall be the lowest 3-month rate.

(B) Lowest 3-month rate. For purposes of subparagraph (A), the term "lowest 3-month rate" means the lowest of the applicable Federal rates in effect for any month in the 3-calendar-month period ending with the 1st calendar month in which there is a binding contract in writing for such sale or exchange.

(3) Term of debt instrument. In determining the term of a debt instrument for purposes of this subsection, under regulations prescribed by the Secretary, there shall be taken into account options to renew or extend.

(e) 110 percent rate where sale-leaseback involved.

- (1) In general. In the case of any debt instrument to which this subsection applies, the discount rate used under subsection (b)(2)(B) or section 483(b) shall be 110 percent of the applicable Federal rate, compounded semiannually.
- (2) Lower discount rates shall not apply. Section 1274A shall not apply to any debt instrument to which this subsection applies.

- (3) Debt instruments to which this subsection applies. This subsection shall apply to any debt instrument given in consideration for the sale or exchange of any property if, pursuant to a plan, the transferor or any related person leases a portion of such property after such sale or exchange.