

at which price a substantial amount of such debt instruments was sold.

(2) Other debt instruments not issued for property

In the case of any issue of 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.

(3) Debt instruments issued for property where there is public trading

In the case of a debt instrument which is issued for property and which—

(A) is part of an issue a portion of which is traded on an established securities market, or

(B)(i) is issued for stock or securities which are traded on an established securities market, or

(ii) to the extent provided in regulations, is 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.

(4) Other cases

Except in any case—

(A) to which paragraph (1), (2), or (3) of this subsection applies, or

(B) to which section 1274 applies,

the issue price of a debt instrument which is issued for property shall be the stated redemption price at maturity.

(5) Property

In applying this subsection, the term “property” includes services and the right to use property, but such term does not include money.

(c) Special rules for applying subsection (b)

For purposes of subsection (b)—

(1) Initial offering price; price paid by the first buyer

The terms “initial offering price” and “price paid by the first buyer” include the aggregate payments made by the purchaser under the purchase agreement, including modifications thereof.

(2) Treatment of investment units

In the case of any debt instrument and an option, security, or other property issued together as an investment unit—

(A) the issue price for such unit shall be determined in accordance with the rules of this subsection and subsection (b) as if it were a debt instrument,

(B) the issue price determined for such unit shall be allocated to each element of such unit on the basis of the relationship of the fair market value of such element to the fair market value of all elements in such unit, and

(C) the issue price of any debt instrument included in such unit shall be the portion of the issue price of the unit allocated to the debt instrument under subparagraph (B).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 536; amended Pub. L. 99-514, title XVIII, §1803(a)(10), Oct. 22, 1986, 100 Stat. 2794.)

AMENDMENTS

1986—Subsec. (b)(3)(B). Pub. L. 99-514 amended subpar. (B) generally, designating existing provisions as cl. (i) and adding cl. (ii).

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1274. 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 semi-annually.

(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)),¹ 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

¹ See References in Text note below.

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 mid-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.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 538; amended Pub. L. 99-121, title I, §§101(a)(1), (b), (c), 102(b), Oct. 11, 1985, 99 Stat. 505, 506, 508; Pub. L. 99-514, title XVIII, §1803(a)(14)(A), Oct. 22, 1986, 100 Stat. 2797; Pub. L. 101-239, title VII, §7721(c)(11), Dec. 19, 1989, 103 Stat. 2400; Pub. L. 104-188, title I, §1704(t)(78), Aug. 20, 1996, 110 Stat. 1891; Pub. L. 105-34, title III, §312(d)(1), Aug. 5, 1997, 111 Stat. 839.)

REFERENCES IN TEXT

Section 6662(d)(2)(C), referred to in subsec. (b)(3)(B)(i), was subsequently amended and cl. (iii) no longer defines the term “tax shelter”. However, such term is defined elsewhere in that section.

AMENDMENTS

1997—Subsec. (c)(3)(B). Pub. L. 105-34 substituted “section 121” for “section 1034”.

1996—Subsec. (b)(3)(B)(i). Pub. L. 104-188 substituted “section 6662(d)(2)(C)(iii)” for “section 6662(d)(2)(C)(ii)”.

1989—Subsec. (b)(3)(B)(i). Pub. L. 101-239 substituted “section 6662(d)(2)(C)(ii)” for “section 6661(b)(2)(C)(ii)”.

1986—Subsec. (c)(3)(A). Pub. L. 99-514 substituted “for \$1,000,000 or less” for “for less than \$1,000,000” in heading of subsec. (c)(4)(A) as so designated prior to its redesignation as subsec. (c)(3)(A) by Pub. L. 99-121, §101(a)(1)(D), see 1985 Amendment note below.

1985—Subsec. (b)(2)(B). Pub. L. 99-121, §101(a)(1)(A), struck out “120 percent of” after “rate equal to”.

Subsec. (c)(1)(A)(ii). Pub. L. 99-121, §101(a)(1)(B), amended cl. (ii) generally, substituting “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(2). Pub. L. 99-121, §101(a)(1)(C), substituted “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(3). Pub. L. 99-121, §101(a)(1)(D), redesignated par. (4) as (3). Former par. (3), defining “testing amount”, was struck out.

Subsec. (c)(4). Pub. L. 99-121, §102(b), added par. (4). Former par. (4) redesignated (3).

Subsec. (d)(1)(B) to (D). Pub. L. 99-121, §101(b)(1), amended subpars. (B) to (D) generally, in subpar. (B) substituting provisions setting a monthly schedule for the determination of Federal rates for provisions which had formerly set a semi-annual schedule for the determination of such rates, in subpar. (C) substituting provisions setting a monthly schedule for the determina-

tion of Federal short-term, mid-term, and long-term rates based on the average market yield during any 1-month period ending in the month in which the determination is made for former provisions which had directed that the Federal rate determined under subpar. (A) apply during the appropriate 6-month period, and in subpar. (D) substituting provisions allowing a lower rate in certain cases for provisions relating to the setting of the Federal rate for any 6-month period.

Subsec. (d)(2). Pub. L. 99-121, § 101(b)(2), amended par. (2) generally. Prior to amendment, par. (2) read as follows: "In the case of any sale or exchange, the determination of the applicable Federal rate shall be made as of the first day on which there is a binding contract in writing for the sale or exchange."

Subsec. (e). Pub. L. 99-121, § 101(c), added subsec. (e).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 applicable to returns the due date for which (determined without regard to extensions) is after Dec. 31, 1989, see section 7721(d) of Pub. L. 101-239, set out as a note under section 461 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1985 AMENDMENT

Pub. L. 99-121, title I, § 105(a), Oct. 11, 1985, 99 Stat. 510, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

"(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by sections 101 and 102 [enacting section 1274A and amending this section and sections 280G and 483 of this title] shall apply to sales and exchanges after June 30, 1985, in taxable years ending after such date. The amendment made by section 2 of Public Law 98-612 [amending section 44(b) of Pub. L. 98-369, set out as a note under section 1271 of this title] shall not apply to sales and exchanges after June 30, 1985, in taxable years ending after such date.

"(2) REGULATORY AUTHORITY TO ESTABLISH LOWER RATE.—Section 1274(d)(1)(D) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], as added by section 101(b), shall apply as if included in the amendments made by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, see Effective Date note set out under section 1271 of this title]."

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to sales or exchanges after Dec. 31, 1984, but not applicable to any sale or exchange pursuant to a written contract which was binding on Mar. 1, 1984, and at all times thereafter before the sale or exchange, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE FOR PURPOSES OF IMPUTED INTEREST RULES

Provisions respecting treatment of debt instruments received in exchange for property, relating to special rules for sales after Dec. 31, 1984, and before July 1, 1985, general rule for assumptions of loans, exception for assumptions of loans made on or before Oct. 15, 1984, and exception for assumptions of loans with respect to certain property, see section 44(b)(4)-(7) of Pub. L. 98-369, as amended, set out as an Effective Date note under section 1271 of this title.

§ 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000

(a) Lower discount rate

In the case of any qualified debt instrument, the discount rate used for purposes of sections 483 and 1274 shall not exceed 9 percent, compounded semiannually.

(b) Qualified debt instrument defined

For purposes of this section, the term "qualified debt instrument" means any debt instrument given in consideration for the sale or exchange of property (other than new section 38 property within the meaning of section 48(b), as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of such instrument does not exceed \$2,800,000.

(c) Election to use cash method where stated principal amount does not exceed \$2,000,000

(1) In general

In the case of any cash method debt instrument—

(A) section 1274 shall not apply, and

(B) interest on such debt instrument shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

(2) Cash method debt instrument

For purposes of paragraph (1), the term "cash method debt instrument" means any qualified debt instrument if—

(A) the stated principal amount does not exceed \$2,000,000,

(B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged,

(C) section 1274 would have applied to such instrument but for an election under this subsection, and

(D) an election under this subsection is jointly made with respect to such debt instrument by the borrower and lender.

(3) Successors bound by election

(A) In general

Except as provided in subparagraph (B), paragraph (1) shall apply to any successor to the borrower or lender with respect to a cash method debt instrument.

(B) Exception where lender transfers debt instrument to accrual method taxpayer

If the lender (or any successor) transfers any cash method debt instrument to a taxpayer who uses an accrual method of ac-