certificated in the United States under the provisions of Section 21.29 of the Federal Aviation Regulations and the applicable airworthiness bilateral agreement.

Since this condition is likely to exist or develop on airplanes of this model registered in the United States, an AD is proposed that would require modification in accordance with the previously mentioned service bulletin.

It is estimated that 33 airplanes of U.S. registry would be affected by this AD, that it would take approximately 9 manhours per airplane to accomplish the required actions, and that the average labor cost would be $40 per manhour. Based on these figures, the total cost impact of this AD to U.S. operators is estimated to be $11,880.

For the reasons discussed above, the FAA has determined that this document (1) involves a proposed regulation which is not major under Executive Order 12291 and (2) is not a significant rule pursuant to the Department of Transportation Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and it is certified under the criteria of the Regulatory Flexibility Act that this proposed rule, if promulgated, will not have a significant economic impact on a substantial number of small entities because few, if any, Short Brothers Model SD3-60 airplanes are operated by small entities. A copy of a draft regulatory evaluation prepared for this action is contained in the regulatory docket.

List of Subject 14 CFR Part 39

Aviation safety, Aircraft.

The Proposed Amendment

PART 39—[AMENDED]

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration proposes to amend § 39.13 of Part 39 of the Federal Aviation Regulations as follows:

1. The authority citation for Part 39 continues to read as follows:

Authority: 49 U.S.C. 1354(a), 1421 and 1423; 49 U.S.C. 106(g) (Revised Pub. L. 97-449, January 12, 1983); and 14 CFR 11-89.

2. By adding the following new airworthiness directive:

Short Brother Ltd.: Applies to Short Brothers Ltd. Model SD3-60 airplanes serial numbers SH 3601 through SH 3665 inclusive, certificated in any category. Compliance is required within 90 days after the effective date of this AD, unless previously accomplished:

1. To prevent control system interference, install extended and additional guards in accordance with Short Brothers Ltd. Service Bulletin SD360-27-04, dated March 1985.

2. Alternate means of compliance which provide an acceptable level of safety may be used when approved by the Manager, Standardization Branch, FAA, Northwest Mountain Region.

3. Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate airplanes to a base for the accomplishment of inspections and/or modifications required by this AD.

All persons affected by this directive who have not already received these documents from the manufacturer may obtain copies upon request to Shorts Aircraft, 1725 Jefferson Davis Highway, Suite 510, Arlington, Virginia 22202. These documents may be examined at the FAA, Northwest Mountain Region, 17900 Pacific Highway South, Seattle, Washington, or 9010 East Marginal Way South, Seattle, Washington.

Issued in Seattle, Washington, on August 13, 1985.

Charles R. Foster,

Northwest Mountain Region.

[FR Doc. 85-19799 Filed 8-19-85; 8:45 am]

BILLING CODE 4910-13-M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[LR-214-84]

Return Relating to Mortgage Interest Received in a Trade or Business From Individuals; Proposed Rulemaking

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations portion of this issue of the **Federal Register**, the Internal Revenue Service is issuing temporary regulations relating to the requirements of reporting mortgage interest received in a trade or business from individuals. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered by October 21, 1985. The regulations are proposed to be effective for mortgage interest received after December 31, 1984.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-214-84), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Annette J. Guarisco of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, Attention: CC:LR:T, (202) 566-3238 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations in the Rules and Regulations portion of this issue of the **Federal Register** amend Parts 1 and 602 of Title 26 of the Code of Federal Regulations. The temporary regulations are designated by a "T" following their section citation. The final regulations, which this document proposes to base on those temporary regulations, would amend Parts 1 and 602 of Title 26 of the Code of Federal Regulations.

The regulations provide guidance concerning information returns relating to mortgage interest received in a trade or business from individuals as required by section 6050H of the Internal Reveune Code of 1954. Section 6050H was added to the Code by section 145 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 685). The regulations are to be issued under the authority contained in sections 6050H and 7805 of the Intrernal Revenue Code of 1954 (98 Stat. 685, 26 U.S.C. 6050H; 68A Stat. 917, 26 U.S.C. 7805). For the text of the temporary regulations, see FR Doc. [T.D. 8047] published in the Rules and Regulations portion of this issue of the **Federal Register**. The preamble to the temporary regulations provides a discussion of the rules.

Special Analyses

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are

submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirement of the Paperwork Reduction Act of 1980. Comments on those requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, DC 20503. The Internal Revenue Service requests that persons submitting comments on those requirements to OMB also send copies to the Service.

Drafting Information

The principal author of these regulations is Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

List of Subjects in 26 CFR 1.6001–1—1.6109–2

Income taxes, Administration and procedure, Filing requirements.

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

[FR Doc. 85–19892 Filed 8–16–85; 8:45 am]

BILLING CODE 4830–01–M

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26 CFR Part 1

[LR–151–83 and LR–179–84]

Registration Requirements With Respect to Certain Debt Obligations; Sanctions on Issuers of Registration-Required Obligations Not in Registered Form; and the Application of the Repeal of 30 Percent Withholding by the Tax Reform Act of 1984

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of notices of proposed rulemaking cross-reference to amendments to temporary regulations.

SUMMARY: This document provides an amended notice of proposed rulemaking relating to the definition of the term "registration-required obligation" with respect to certain types of obligations, relating to the imposition of sanctions on issuers issuing registration-required obligations in bearer form, and relating to the repeal of the 30 percent withholding tax on certain types of interest by the Tax Reform Act of 1984. This document amends notices of proposed rulemaking published in the Federal Register at 49 FR 33275, and 49 FR 33276. In the Rules and Regulations portion of this Federal Register, the Internal Revenue Service is issuing amendments to temporary income tax regulations relating to the definition of the term "registration-required obligation" with respect to certain obligations, the imposition of sanctions on issuers issuing registration-required obligations in bearer form, and the repeal of 30 percent withholding by the Tax Reform Act of 1984. The text of those amended temporary regulations serve as the comment document for this notice of proposed rulemaking.

DATE: Written comments and requests for a public hearing must be delivered or mailed before October 21, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR–151–83 and LR–179–84).

FOR FURTHER INFORMATION CONTACT: P. Ann Fisher of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, Attention: CC:LR:T [LR–151–83 and LR–179–84], 202–566–3289.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations published in the Rules and Regulations portion of this issue of the Federal Register amend existing temporary regulations by adding paragraph (d) to § 1.163–5T, revising subdivisions (v) and (vi) of §§ 1.163–5T(c) (2), revising Q & As 10, 12, 14, and 15 of § 35a.9999–5 (b), and adding paragraph (d) to § 35a.9999–5 consisting of Q & A 20. For the text of the temporary regulations, see FR Doc. 85–19893 [T.D. 8046] published in the Rules and Regulations portion of this issue of the Federal Register.

Regulatory Flexibility Act and Executive Order 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of a proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Comments and Requests for a Public Hearing

Before adopting these proposed regulations as final regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Drafting Information

The principal author of this regulation is P. Ann Fisher of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of substance and style.

List of Subjects

26 CFR 1.16–1 Through 1.281–4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR 1.861–1 through 1.997–1

Income taxes, Aliens, Exports, DISC, Foreign investments in U.S., Foreign tax credit, FSC, Sources of income, United States investments abroad.

26 CFR Part 35a

Employment taxes, Income taxes, Backup withholding, Interest and Dividend Tax Compliance Act of 1983.

Proposal of Regulations

The temporary regulations, FR Doc. 85–19893 [T.D. 8046] published in the Rules and Regulations portion of this issue of the Federal Register, are hereby also proposed as final regulations under section 163, 871, and 881 of the Internal Revenue Code of 1954.

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

[FR Doc. 85–19894 Filed 8–16–85; 10:29 am]

BILLING CODE 4830–01–M

26 CFR Parts 1, 20, 25, and 53 and 602

[LR-165-84]

Below-Market Loans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the Federal tax treatment of both the lender and the borrower in certain below-market interest rate loan transactions. Changes to the applicable tax law were made by the Tax Reform Act of 1984. These regulations would affect taxpayers who enter into certain below-market loans and provide them with guidance needed to comply with the law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by October 21, 1985. The regulations are generally proposed to be effective after June 6, 1984, for below-market term loans made after June 6, 1984, and below-market demand loans outstanding after June 6, 1984. Section 1.7872-1(c) provides special effective date rules for certain loan transactions.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-165-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3828 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1), the Estate Tax Regulations (26 CFR Part 20), the Gift Tax Regulations (26 CFR Part 25) and the Excise Tax Regulations (26 CFR Part 53) under section 7872 of the Internal Revenue Code of 1954. This document also amends the Table of OMB Control Numbers (26 CFR Part 602). These amendments are proposed to provide regulations under new section 7872, which was added to the Code by section 172 of the Tax Reform Act of 1984 (98 Stat. 699).

In General

Prior to the enactment of section 7872, some taxpayers used interest-free loans or loans with an interest rate below the current market rate (in each case, "below-market loans") which purported to circumvent well-established rules of taxation. Thus, in family or similar situations, below-market loans have been used which purported to have the effect of avoiding taxation under the grantor trust rules and deflecting income to others. Corporations have made below-market loans to shareholders with the effect of avoiding taxation of income at the corporate level which is the economic equivalent of receiving a deduction for dividends paid to those shareholders. Employers have made below-market loans to employees with the effect of providing compensation which has not been subject to employment taxes. Interest-free loans have also been used to convert non-deductible expenses into the equivalent of deductible expenses.

Section 7872 addresses these and similar practices, generally, by treating certain below-market loans described in one of the categories specified in section 7872(c) as economically equivalent to loan bearing interest at the applicable Federal rate coupled with a payment by the lender to the borrower sufficient to fund the payment of interest by the borrower. Thus, the lender is treated as making (i) a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate, and (ii) a transfer of funds to the borrower in an amount generally equal to the amount of interest imputed under section 7872. In the case of term gift loans, however, the amount of money treated as transferred by the lender to the borrower, which is subject to gift tax, and the amount of the imputed interest payment by the borrower to the lender are unequal because they are computed differently under the statute.

Character and Timing of Transfers

The character of the imputed transfer by the lender to the borrower is determined in accordance with the substance of the transaction. For example, the transfer is treated as a gift if the transaction is in substance a gift within the meaning of the gift tax provisions of the Code, and it is treated as compensation if the purpose of the transaction is the payment of compensation. This imputed transfer is computed annually and in the case of demand loans is treated as made, generally, on December 31. In the case of term loans, however, the imputed transfer is treated as made at the time the loan is made.

The timing and amount of the imputed interest payments by the borrower to the lender depend on the character of the amount transferred by the lender to the borrower and on whether the loan is a term or a demand loan. The imputed interest payment in the case of gift and demand loans is computed annually and generally is treated as transferred on December 31. The imputed interest payment in the case of term loans other than gift loans is computed on the date the loan is made and is subject to the original issue discount rules of section 1272.

Definition of Loan

Because the purpose of section 7872 is to eliminate the use of below-market loans as a vehicle for tax avoidance, the term "loan" is interpreted broadly in the regulations. Accordingly, any extension of credit or any transaction under which the owner of money permits another person to use the money for a period of time after which the money is to be transferred back to the owner or applied according to an agreement with the owner, such as a refundable deposit, is a loan for purposes of section 7872. However, only those below-market loans that are gift loans, compensation-related loans, corporation-shareholder loans, tax avoidance loans or loans to be specified as significant-effect loans (see below), are subject to the provisions of section 7872. Proposed § 1.7872-4(g) provides a special rule for a below-market loan which is made between two persons and is attributable to the relationship of a third person to either the lender or the borrower (for example, a loan by an employer to the child of an employee). In this case, the loan is restructured as two successive "indirect" loans for purposes of section 7872. In addition, the regulations provide that if a lender and a borrower use another entity as an intermediary or middleman, such as in a "back-to-back" loan transaction, for the purpose of avoiding the application of section 7872, the intermediary will be ignored and the two loans will be restructured as one loan made directly between the lender and the borrower.

Section 7872(c)(1)(B)(ii) states that loans between an independent contractor and a person for whom the independent contractor provides services are subject to section 7872. In addition, the proposed regulations define a loan to include any transaction which would be treated as a refundable deposit under current law. Accordingly, if a taxpayer makes a refundable deposit to an independent contractor in connection with the performance of services, the deposit will be subject to the imputation rules of section 7872 (unless the *de minimis* rules are applicable). The Service is aware that cash amounts are frequently deposited with independent contractors in the

ordinary course of business and characterized by the parties as prepayments rather than refundable deposits. Consequently, if this characterization is appropriate, those amounts would not be subject to section 7872. The proper distinction between refundable deposits and prepayments is a factual determination, and, to assist the Service in developing guidelines for drawing this distinction, interested parties are invited to comment on this issue.

Partnerships and Partners

The Service is aware that some taxpayers have entered into below-market loans with partnerships and that other taxpayers have achieved the economic and tax result afforded a below-market loan transaction by utilizing partnerships and the tax laws under subchapter K. The proposed regulations provide that certain below-market loans made by a partnership to a partner that are made in consideration for services preformed by the partner other than in his capacity as a member of the partnership will be treated as compensation-related loans for purposes of section 7872.

The final regulations under section 7872 will further address the relationship of section 7872 to partnership transactions, such as certain purported distributions which, under the facts and circumstances, may properly be characterized as loans. The Service is considering several proposals regarding the application of section 7872 to transactions between partners and partnerships and requests interested taxpayers to submit written comments on this point.

Significant Effect Loan

In addition to the four enumerated categories of below-market loans, section 7872(c)(1)(E) provides regulatory authority for applying section 7872 to any other below-maket loan if "the interest arrangements of such loan have a significant effect on any Federal tax liability of the lender or the borrower." The Conference Report accompanying the Tax Reform Act of 1984 states, among other things, that any loan that results in the conversion of a nondeductible expense into the equivalent of a deductible expense has an effect on the tax liability of the borrower or lender. The Conference Report further provides that whether an effect is significant is determined in light of all the facts and circumstances including:

(1) Whether the items of income and deduction generated by the loan offset each other;

(2) The amount of such items;

(3) The cost to the taxpayer of complying with the provision; and

(4) Any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

The Service is aware of numerous situations in which below-market loans have the potential to convert nondeductible personal expenses into the equivalent of deductible expenses. This potential is particularly apparent where interest earned on the borrowed amount may be used to compensate (or provide additional compensation to) the borrower for services or property provided to the lender. Examples of these situations include:

(1) Loans to a membership organization in lieu of part or all of a membership fee;

(2) Loans to institutions providing meals, lodging, and/or medical services (*e.g.*, continuing care facilities) in lieu of fees for such services;

(3) Loans to colleges and secondary schools in lieu of part or all of the tuition, room, and board that would otherwise be changed; and

(4) Loans to an employee or independent contractor by an employer in lieu of payment for a service provided to such employer by the employee (*e.g.*, housing, life insurance coverage, health care).

Many of these transactions have a significant potential for distortion of tax liability, especially if the amounts loaned are relatively large. The Service has decided, however, not to propose regulations treating transactions as having a significant effect until further comment is received on how the facts and circumstances test should be applied, including the proper role of the factors cited by the Conference Report. The Service intends to hold a hearing after publication of these proposed regulations, if a public hearing is requested by any person who submits written comments. The Service urges taxpayers to submit written comments and to speak on this point at that hearing. No transaction will be treated under the regulations as a significant effect loan earlier than the date that future regulations under section 7872(c)(1)(E) are published in proposed form.

Exclusion From Section 7872

Proposed §§ 1.7872-7 and 1.7872-8 provide for the exclusion of certain below-market loans from the rules of section 7872. Generally, if the amount of loans between a lender and a borrower does not exceed $10,000, section 7872 does not apply. Furthermore, in the case of gift loans of less than $100,000, directly between natural persons, the imputed interest payment by the borrower to the lender each year generally is limited to the amount of the borrower's net investment income (as defined section 7872(d)(1)(E)) for the taxable year.

In addition, section 7872(g)(1)(C) provides regulatory authority for exempting from the application of section 7872 any class of transactions if the application of section 7872 would not have a significant effect on any Federal tax liability of the lender or the borrower. Accordingly, proposed § 1.7872-5 provides that certain below-market loans which are not structured as such for tax avoidance purposes are exempted from the provisions of section 7872. If, however, such a loan is structured as one of the exempted loans for tax avoidance purposes, the Service may recharacterize the transaction according to its economic substance and apply section 7872 in accordance with its terms. Interested taxpayers are invited to comment on whether other transactions should be exempted from section 7872, and on the proper tax treatment under section 7872 of private placements of convertible debt.

Section 7872(f)(8) provides that section 7872 does not apply to any loan to which section 483 or 1274 applies. The regulations clarify that generally section 7872 does not apply to any loan to which section 483 or 1274 could apply even though the rules of those sections do not apply because of exceptions or safe harbor provisions in one of those sections. The regulations further clarify that debt instruments issued for property and payable on demand, debt instruments described in section 1273(b)(3) and debt instruments described in section 1275(b) are not subject to sections 483 and 1274 and are subject to section 7872 if those instruments are described in section 7872(c)(1) (A), (B), or (C).

Certain loans subject to section 7872 are also described in section 482 of the Code (concerning the allocaton of income and deductions among related taxpayers). These regulations provide for one limited exception to section 7872 in the case of a loan which is also described in § 1.482-2(a)(3), concerning indebtedness arising in the ordinary course of business out of sales, leases, or the rendition of services by or between members of a group outstanding for six months or less (the "open accounts exception"). This limited

exception will expire on June 30, 1986, by which time the Service plans to have completed its review of the commercial need for an exception from section 7872 in the case of certain "open account" transactions between parties described in section 7872. The Service invites written comments on this issue.

Where an employer makes a below-market term loan to an employee in certain circumstances, the loan is treated for purposes of section 7872 as a demand loan under section 7872(f)(5). In the case where the employer disposes of his interest in the loan by sale to a third party, questions have arisen regarding the proper tax treatment of the employer, employee and third-party purchaser. The Service is considering alternative ways to resolve the issues raised in these circumstances, consistent with the following principles:

(1) The employee should remain subject to section 7872(a)(1), so long as that section would be applicable if the employer had not sold his interest in the loan; and

(2) The disposition of the loan should not present opportunities for tax avoidance that would not arise had the employer not disposed of its interest in the loan.

When promulgated, these rules may also apply to certain loans, such as employee relocation loans, which are generally exempted from the statute under § 1.7872–5. The Internal Revenue Service invites comments concerning this issue.

Foreign Currency Loans

The proposed regulations state that for purposes of applying the below-market loan rules to loans denominated in a foreign currency, a market rate of interest appropriate for that currency shall be used in lieu of the applicable Federal rate. However, the proposed regulations expressly leave open the question of how the imputed transfer from the borrower to the lender is to be treated for tax purposes. The Service is aware that high nominal rates of interest in currencies expected to depreciate with respect to the dollar may overstate the true cost of borrowing to a U.S. taxpayer if offsetting foreign currency gains are not taken into account. Conversely, low rates of interest in currencies expected to appreciate with respect to the dollar may understate true borrowing costs. The Service is studying this issue further, in the context of transactions governed by section 7872 as well as those governed by sections 1271 through 1275, and plans to address this issue in future regulations under these sections.

Request for Comments on Certain Transactions

The Service is aware that numerous transactions which occur in the ordinary course of business in many industries may be characterized under section 7872(c)(1)(B) as compensation-related loans. (One example is a transaction in which a cash margin deposit is made pursuant to requirements of an exchange to a futures commission merchant or to the exchange as a condition for trading futures contracts. See § 1.7872–5 for a special temporary rule pending comments.) In order to determine whether these transactions are subject to section 7872 and whether the interest arrangements of such transaction have a significant effect on the Federal tax liability of the lender or borrower, the Service requests that taxpayers submit written comments providing a full explanation of the transactions.

The Service is also aware that other persons subject to section 7872 may enter into numerous short-term demand loans for business-related or other purposes. (One example is short-term loans resulting from the extension of credit through the use of a credit card. See § 1.7872–10(a)(6) for a special rule relating to revolving credit loans.) Because of the volume and the short-term nature of the loans in these situations, the Service is also considering whether special rules of convenience can be formulated in some circumstances to reduce the cost of compliance without creating opportunities for manipulation or tax avoidance. The Service invites comments and suggestions with respect to such possible rules of convenience, the circumstances in which they would be applicable, and any exceptions that may be necessary if such rules are adopted.

Applicable Federal Rate

Under the proposed regulations, the applicable Federal rate in effect at any time depends upon the Federal statutory rates established for semiannual periods and the alternate Federal rates established by the Commissioner on a monthly basis (see § 1.1274–3T). The Federal statutory rates and the alternate Federal rates are published by the Commissioner along with equivalent rates which are based on different compounding periods. The choice of the appropriate Federal statutory rate or alternate Federal rate for any loan depends upon the payment intervals or compounding periods required under the loan agreement. The regulations provide special rules to permit use of the alternate Federal rate in the case of demand loans. In addition, the proposed regulations provide special rules for certain variable interest rate loans.

Unascertainable Term

The proposed regulations do not address the treatment of term loans in the case where the period for which the loan is outstanding is unascertainable. For example, a loan which must be repaid when the borrower marries is a term loan outstanding for an unascertainable period of time. In order to make the calculation required by section 7872(b), it is necessary to know the period of time that the term loan is outstanding. The Service invites comments on this issue.

Other Issues: Consistency; Estate and Gift Tax Rules; Private Foundations

Section 7872(g)(1)(B) provides regulatory authority for assuring that the positions of the lender and borrower are consistent as to the application or nonapplication of section 7872. Accordingly, proposed § 1.7872–11(f) provides that the lender and the borrower each must attach a statement to their income tax returns for any taxable year in which they either have imputed income or claim a deduction for an amount imputed under section 7872.

In addition, proposed § 20.7872–1 implements section 7872(g)(2) by prohibiting the discounting, at other than the applicable Federal rate, for estate tax purposes, of any term loan made by a decedent with donative intent after June 6, 1984. Proposed § 25.7872–1 implements section 7872(a) by providing that the amount transferred by the lender to the borrower and characterized as a gift is subject to the gift tax provisions. Finally, § 53.4941(d)–2 is amended to provide that the amount of interest on loans between a disqualified person and a private foundation is computed without regard to section 7872 for purposes of application of the excise tax imposed by that section.

Effective Dates

In general, the provisions of section 7872 apply after June 6, 1984, to term loans made after June 6, 1984, and to demand loans outstanding after June 6, 1984. If, however, a demand loan that was outstanding after June 6, 1984, is retired before September 17, 1984, the provisions of section 7872 will not apply to the demand loan for the period ending on the date on which the loan is retired. For this purpose, the demand loan is retired by repayment, cancellation, forgiveness, modification of the interest arrangement, or some other similar

action (see Internal Revenue Service News Release, IR-84-95, published August 28, 1984).

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is to be held, notice of the time and place will be published in the **Federal Register.**

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504 (h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

Special Analysis

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accodringly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the proposed regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Drafting Information

The principal author of these proposed regulations is Howard A. Balikov of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

List of Subjects

26 CFR 1.7872-1 to 1.7872-14

Income tax, Gift tax, Below-market loans.

26 CFR Part 20

Estate taxes.

26 CFR Part 25

Gift Taxes.

26 CFR Part 53

Excise taxes, Foundations, Investments, Trusts and trustees.

26 CFR Part 602

Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations.

The proposed amendments to 26 CFR Part 1, 26 CFR Part 20, 26 CFR Part 25, 26 CFR Part 53, and 26 CFR Part 602 are as follows:

Income Tax Regulations

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §§ 1.7872-1 through 1.7872-14 also issued under 26 U.S.C. 7872.

Par. 2. New §§ 1.7872-1 through 1.7872-14 are added in the appropriate place. These new sections read as follows:

§ 1.7872-1 Introduction.

(a) *Statement of purpose.* Section 7872 generally treats certain loans in which the interest rate charged is less than the applicable Federal rate as economically equivalent to loans bearing interest at the applicable Federal rate, coupled with a payment by the lender to the borrower sufficient to fund all or part of the payment of interest by the borrower. Such loans are referred to as "below-market loans." See § 1.7872-3 for detailed definitions of below-market loans and the determination of the applicable Federal rate. Accordingly, section 7872 recharacterizes a below-market loan as two transactions:

(1) An arm's-length transaction in which the lender makes a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate; and

(2) A transfer of funds by the lender to the borrower ("imputed transfer").

The timing and the characterization of the amount of the imputed transfer by the lender to the borrower are determined in accordance with the substance of the transaction. The timing and the amount of the imputed interest payment (the excess of the amount of interest required to be paid using the applicable Federal rate, *over* the amount of interest required to be paid according to the loan agreement) by the borrower to the lender depend on the character of the imputed transfer by the lender to the borrower and whether the loan is a term loan or a demand loan. If the imputed transfer by the lender is characterized as a gift, the provisions of chapter 12 of the Internal Revenue Code, relating to gift tax, also apply. All imputed transfers under section 7872 (*e.g.*, interest, compensation, gift) are characterized in accordance with the substance of the transaction, and, except as otherwise provided in the regulations under section 7872, are treated as so characterized for all purposes of the Code. For example, for purposes of section 170, an interest-free loan to a charity referred to in section 170 for which interest is imputed under section 7872, is treated as an interest bearing loan coupled with periodic gifts to the charity in the amount of the imputed transfer, for purposes of section 170. In addition, all applicable information and reporting requirements (*e.g.*, reporting on Form W-2 and Form 1099) must be satisfied.

(b) *Effective date*—(1) *In general.* The provisions of section 7872 generally apply, for periods after June 6, 1984, to demand loans outstanding after that date and to loans other than demand loans made after that date.

(2) *Demand loans repaid before September 17, 1984.* If a demand loan which was outstanding on June 6, 1984, is repaid before September 17, 1984, section 7872 does not apply to the loan. For purposes of this paragraph (b)(2) only, a loan is treated as repaid if it is repaid, cancelled, forgiven, modified, or otherwise retired. For example, if the loan agreement for an interest-free demand loan, which is outstanding on June 6, 1984, is modified on September 10, 1984, to require the borrower to pay a 5 percent simple rate of interest, then for purposes of this paragraph (b)(2) the original loan is treated as repaid on September 10, 1984, and section 7872 applies to the modified loan beginning on that date.

(3) *Change in loan agreement.* For purposes of section 7872, any loan which is renegotiated, extended, or revised after June 6, 1984, is treated as a loan made after June 6, 1984. Accordingly, for purposes of the effective date provisions of this paragraph (b) in the case of such a loan, the provisions of section 7872 apply as if the loan were a new loan

made on the day the lender and borrower enter into a binding agreement to change the provisions of the loan.

(4) *Other Federal tax consequences.* Section 7872 does not alter the law applicable to below-market loans for periods prior to the effective date of section 7872. Accordingly, below-market interest rate loans which are not subject to section 7872 by reason of the effective date provisions of this paragraph (b), including loans which are repaid under the rule described in paragraph (b)(2) of this section, may still have Federal tax consequences. *See, e.g., Dickman* v. *Commissioner,* 465 U.S. —— (1964), 104 S.Ct. 1086.

(c) *Key to Code provisions.* The following key is intended to facilitate research with respect to specific Code provisions. The key identifies the regulations section in which the principal discussion of a particular Code provision appears. As a result of the interrelationship among Code provisions, other regulation sections may also discuss the particular Code provision. Section 1.7872–2 deals with the definition of the term "loan" for purposes of section 7872. The following table identifies the provisions of section 7872 that are dealt with in §§ 1.7872–2 through 1.7872–14 and lists each provision of Code secion 7872 below the regulation section in which it is covered.

§ 1.7872–2
(f)(8)

§ 1.7872–3
(e)(1)
(f)(2)
(g)(1)(A)

§ 1.7872–4
(c)(1)
(f)(3)

§ 1.7872–5
(g)(1)(C)

§ 1.7872–6
(a)
(d)(2)

§ 1.7872–7
(a)
(d)(2)
(f)(1)
(f)(4)
(f)(10)

§ 1.7872–8
(c)(2)
(d)(1)

§ 1.7872–9
(c)(3)
(f)(10)

§ 1.7872–10
(f)(5)
(f)(6)

§ 1.7872–11
(f)(7)
(f)(9)
(g)(1)(A)
(g)(1)(B)

§ 1.7872–12
(e)(1)(A)

§ 1.7872–13
(e)(2)

§ 1.7872–14
(e)(1)(B)
(f)(1)

See § 20.7872–1 for regulations under section 7872(g)(2).

See § 25.7872–1 for gift tax regulations.

See § 53.4941(d)–2 for interest-free loans between private foundations and disqualified persons.

§ 1.7872–2 Definition of loan.

(a) *In general*—(1) *"Loan" interpreted broadly.* For purposes of section 7872, the term "loan" includes generally any extension of credit (including, for example, a purchase money mortgage) and any transaction under which the owner of money permits another person to use the money for a period of time after which the money is to be transferred to the owner or applied according to an express or implied agreement with the owner. The term "loan" is interpreted broadly to implement the anti-abuse intent of the statute. An integrated series of transactions which is the equivalent of a loan is treated as a loan. A payment for property, goods, or services under a contract, however, is not a loan merely because one of the payor's remedies for breach of the contract is recovery of the payment. Similarly, a bona fide prepayment made in a manner consistent with normal commercial practices for services, property, or the use of property, generally, is not a loan; see section 461 and the regulations thereunder for the treatment of certain prepaid expenses and for the special rules of sections 461 (h) and (i). However, a taxpayer's characterization of a transaction as a prepayment or as a loan is not conclusive. Transactions will be characterized for tax purposes according to their economic substance, rather than the terms used to describe them. Thus, for example, receipt by a partner from a partnership of money is treated as a loan if it is so characterized under § 1.731–1(c)(2).

(2) *Limitations on applicability of section 7872*—(i) *In general.* Section 7872 applies only to certain below-market loans (as defined in section 7872(e)(1)). Section 1.7872–4 lists the categories of below-market loans to which section 7872 generally applies. Certain below-market loans within these categories, however, are exempt from the provisions of section 7872. See § 1.7872–5 for specific exemptions from the rules.

(ii) *Loans to which section 483 or 1274 applies.* Generally, section 7872 does not apply to any loan which is given in consideration for the sale or exchange of property (within the meaning of section 1274(c)(1)) or paid on account of the sale or exchange of property (within the meaning of section 483(c)(1)), even if the rules of those sections do not apply by reason of exceptions or safe harbor provisions. Any transaction, however, which otherwise is described in section 7872(c)(1) (A), (B), or (C), and is—

(A) A debt instrument that is issued in exchange for property and that is payable on demand,

(B) A debt instrument described in section 1273(b)(3), or

(C) A debt instrument described in section 1275(b), unless the transaction is described in § 1.7872–5(b)(1).

is not subject to sections 483 and 1274 and is subject to section 7872.

(iii) *Relation to section 482.* If a below-market loan subject to section 7872 would also be subject to section 482 if the Commissioner chose to apply section 482 to the loan transaction, then section 7872 will be applied first. If the Commissioner chooses to apply section 482, then the loan transaction is subject to section 482 in addition to section 7872.

(3) *Loan proceeds transferred over time.* In general, each extension or credit or transfer of money by a lender to a borrower is treated as a separate loan. Accordingly, if the loan agreement provides that the lender will transfer the loan proceeds to the borrower in installments, each installment payment is treated as a separate loan. Similarly, in the case of a loan in which the transfer of the loan proceeds to the borrower is subject to a draw-down restriction, each draw-down of loan proceeds is treated as a separate loan.

(b) *Examples of transactions treated as loans*—(1) *Refundable Deposits*—(i) *In general.* If an amount is treated for Federal tax purposes as a deposit rather than as a prepayment or an advance payment, the amount is treated as a loan for purposes of section 7872.

(ii) *Partially refundable deposits.* If an amount is treated for Federal tax purposes as a deposit rather than as a prepayment or an advance payment and the amount is refundable only for a certain period of time or is only partially refundable, then the deposit is treated as a loan only to the extent that it is refundable and only for the period of time that it is refundable.

(iii) *Exception.* Paragraph (b)(1)(i) of this section does not apply if the deposit is custodial in nature or is held in trust for the benefit of the transferor. The deposit is treated as custodial in nature if the transferee is not entitled to the beneficial enjoyment of the amount deposited including interest thereon (except as security for an obligation of the transferor). Thus, if an amount is placed in escrow to secure a contractual obligation of the transferor, and the escrow agreement provides that all interest earned is paid to the transferor and that the transferee has no rights to or interest in the escrowed amount unless and until the transferor defaults on the obligation, then, in the absence of any facts which indicate that the transaction was entered into for tax avoidance purposes, the deposit is not a loan.

(2) *Permitting agent or intermediary to retain funds.* An agreement under which an agent or intermediary is permitted to retain possession of money for a period of time before transferring the money to his or her principal is treated as a loan for purposes of section 7872. For example, a taxpayer who enters into an agreement with a broker under which the broker may retain possession of the proceeds from the sale of the taxpayer's property (*e.g.*, securities issued by the taxpayer) for a period of time and uses or invests those funds (other than for the taxpayer's account) is treated as making a loan to the broker for the period of time that the broker retains possession of the proceeds.

(3) *Advances.* An advance of money to an employee, salesman, or other similar person to defray anticipated expenditures is not treated as a loan for purposes of section 7872 if the amount of money advanced is reasonably calculated not to exceed the anticipated expenditures and if the advance of money is made on a day within a reasonable period of time of the day that the anticipated expenditure will be incurred. An advance or draw of money against a partner's distributive share of income which is treated in the manner described in § 1.731–1(a)(1)(ii) is not a loan for purposes of section 7872.

§ 1.7872–3 Definition of below-market loans.

(a) *In general.* Section 7872 does not impute interest on loans which require the payment of interest at the applicable Federal rate. This section defines the applicable Federal rate and provides rules for determining whether an interest-bearing loan provides sufficient stated interest to avoid classification as a below-market loan. The term "below-market loan" means any loan if—

(1) In the case of a demand loan, interest is payable at a rate less than the applicable Federal rate; or

(2) In the case of a term loan, the amount loaned exceeds the present value of all payments due under the loan, determined as of the day the loan is made, using a discount rate equal to the applicable Federal rate in effect on the day the loan is made.

Sections 1.7872–13 and 1.7872–14 contain the computations necessary for determining the amount of imputed interest on a below-market loan which is subject to section 7872.

(b) *Applicable Federal rate*—(1) *In general.* The applicable Federal rate is an annual stated rate of interest based on semiannual compounding. In addition, the Commissioner may prescribe equivalent rates based on compounding periods other than semiannual compounding (for example, annual compounding, quarterly compounding, and monthly compounding), to facilitate application of this section to loans other than those involving semiannual payments or compounding. Thus, loans providing for annual payments or annual compounding of interest over the entire life of the loan will use the applicable Federal rates based on annual compounding; loans providing for quarterly payments or quarterly compounding over the entire life of the loan will use the applicable Federal rates based on quarterly compounding; and loans providing for monthly payments or monthly compounding over the entire life of the loan will use the applicable Federal rates based on monthly compounding. The shorter of the compounding period or the payment interval determines which rate is appropriate. Loans providing for payments or compounding of interest at other intervals (*e.g.*, daily, weekly, bi-monthly) may use the applicable Federal rates published by the Commissioner based on the shortest compounding period that is longer than the shorter of the compounding period or the payment interval provided for over the entire life of the loan. Thus, loans providing for daily or weekly payments or compounding of interest may use the applicable Federal rate based on monthly compounding; loans providing for bi-monthly payments or compounding of interest will use the applicable Federal rates based on quarterly compounding; etc. Alternatively, taxpayers may compute and use interest rates other than those published by the Commissioner for other interest payment or compounding periods if such rates are equivalent to the applicable Federal rates. Any reference to the applicable Federal rate in the regulations under section 7872 includes the equivalent rates based on different compounding or payment periods.

(2) *Determination of applicable Federal rate*—(i) *In general.* The applicable Federal rate for loans described in paragraphs (b)(3), (4), and (5) of this section is defined by reference to Federal statutory rates and alternate Federal rates.

(ii) *Definition of Federal statutory rate.* The Federal statutory rates are the short-, mid-, and long-term rates in effect under section 1274(d) and their equivalent rates based on different compounding assumptions. These rates are published by the Commissioner for each semiannual period January 1 through June 30 and July 1 through December 31.

(iii) *Definition of alternate Federal rate.* The alternate Federal rates are the short-, mid-, and long-term rates established by the Commissioner on a monthly basis, and their equivalent rates based on different compounding assumptions. These rates are published by the Commissioner on a monthly basis.

(iv) *Definition of semiannual period.* For purposes of section 7872 and the regulations thereunder, the first semiannual period means the period in any calendar year beginning on January 1 and ending on June 30, and the second semiannual period means the period in any calendar year beginning on July 1 and ending on December 31.

(3) *Demand loans*—(i) *In general.* In the case of a demand loan, the applicable Federal rate for a semiannual period (January 1 through June 30 or July 1 through December 31), is the lower of:

(A) The Federal statutory short-term rate in effect for the semiannual period; or

(B) The special rate for demand loans described in paragraph (b)(3)(ii) of this section.

(ii) *Special rate for demand loans.* The special rate for demand loans is—

(A) For the semiannual period in which the loan is made, the alternate Federal short-term rate which is in effect on the day the loan is made; and

(B) For each subsequent semiannual period in which the loan is outstanding, the alternate Federal short-term rate which is in effect for the first month of that semiannual period (*i.e.*, January or July).

For a special safe harbor rule for certain variable interest rate demand loans, see paragraph (c)(2) of this section.

(4) *Term loans.* In the case of a term loan, including a gift term loan or a term loan that is treated as a demand loan as provided in § 1.7872–10(a)(5), the applicable Federal rate is the lower of:

(i) The Federal statutory rate for loans of that term in effect on the day the loan is made; or

(ii) The alternate Federal rate for loans of that term in effect on the day the loan is made.

(5) *Loans conditioned on future services.* In the case of a term loan that is treated as a demand loan as provided in § 1.7872–10(a)(5), on the date the condition to preform substantial services is removed or lapses, the demand loan is treated as terminated and a new term loan is created. The applicable Federal rate for the new term loan is the lower of the following:

(i) The applicable Federal rate in effect on the day the original loan was made; or

(ii) The applicable Federal rate in effect on the day the condition lapses or is removed.

(6) *Periods before January 1, 1985.* For term loans made and demand loans outstanding after June 6, 1984, and before January 1, 1985, the applicable Federal rate under section 7872(f)(2) is as follows:

(i) 10.25 percent, compounded annually;

(ii) 10.00 percent, compounded semiannually;

(iii) 9.88 percent, compounded quarterly; and

(iv) 9.80 percent, compounded monthly.

(c) *Loans having sufficient stated interest.*—(1) *In general.* Section 7872 does not apply to any loan which has sufficient stated interest. A loan has sufficient stated interest if it provides for interest on the outstanding loan balance at a rate no lower than the applicable Federal rate based on a compounding period appropriate for that loan. See paragraph (b)(1) of this section for a description of appropriate compounding periods. See § 1.7872–11(a) for rules relating to waiver of interest.

(2) *Safe harbor for demand loans.* If the interest rate on a demand loan is changed, either under the terms of the original loan agreement, or subsequently, the loan will be treated as a new loan for purposes of determining the applicable Federal rate for that loan. Thus, the loan will have sufficient stated interest for the remainder of the semiannual period following such change of interest rate if the new interest rate is not less than the lower of the Federal statutory short-term rate in effect for the semiannual period or the alternate Federal short-term rate in effect on the day the new interest rate takes effect.

(3) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). On December 1, 1984, A makes a $100,000 5-year gift term loan to B, requiring 10 interest payments of $5,000 each, payable on May 31 and November 30 of each year the loan is outstanding. Since the loan requires semiannual interest payments, the appropriate compounding assumption is semiannual compounding. For term loans made during 1984, the applicable Federal rate based on semiannual compounding is 10 percent. The loan is not a below-market loan because it provides for interest at a rate of 10 percent, payable semiannually.

Example (2). Assume the same facts as in Example (1), except that the loan requires 5 annual interest payments of $10,000 each, payable on November 30 of each year the loan is outstanding. Since the loan requires annual interest payments, the appropriate compounding assumption is annual compounding. The loan is a below-market loan because, although interest is stated at a rate of 10 percent, a rate that reflects semiannual compounding is not appropriate for a loan with annual payments.

Example (3). Assume the same facts as in Example (2), except that the loan requires 5 annual payments of $10,250 each, payable on November 30 of each year that the loan is outstanding. Since the loan requires annual interest payments, the appropriate compounding assumption is annual compounding. For term loans made during 1984, the applicable Federal rate based on annual compounding is 10.25 percent. The loan is not a below-market loan because it provides for interest at a rate of 10.25 percent, compounded annually.

Example (4). Assume the same facts as in Example (1), except that the loan requires 120 monthly interest payments of $816.67 each, payable on the last calendar day of each month that the loan is outstanding. Since the loan requires monthly interest payments, the appropriate compounding assumption is monthly compounding. The loan is not a below-market loan because it requires monthly payments of interest based on a rate of 9.80 percent, the applicable Federal rate of interest based on monthly compounding.

Example (5). (i) A makes a demand loan to her son, B, on April 1, 1985. The loan requires quarterly interest payments due at the end of each calendar quarter at a rate of 10 percent. Assume that on April 1, 1985, the Federal statutory short-term rate in effect is 12 percent, compounded quarterly, and that the alternate Federal short-term rate in effect for the month of April is 10 percent, compounded quarterly. The loan is not a below-market loan for the period April 1, 1985, through June 30, 1985.

(ii) Assume that on July 1, 1985, the Federal statutory short-term rate in effect is 11 percent, compounded quarterly, and the alternate Federal short-term rate in effect for the month of July is 10.20 percent, compounded quarterly. The loan no longer has sufficient stated interest. If A raises the interest rate to at least 10.20 percent, the loan will have sufficient stated interest and will not be a below-market loan for the period of July 1 through December 31, 1985.

(iii) Assume that on July 1, 1985, A increases the interest rate on the loan to 10.20 percent, a rate equal to the alternate Federal short-term rate in effect for July. Further assume that the alternate Federal short-term rate subsequently decreases so that such rate in effect for the month of August decreases to 10 percent. On August 1, 1985, A lowers the interest rate on this loan to 10 and does not change that rate for the remainder of the semiannual period. The loan has sufficient stated interest and will not be a below-market loan for the semiannual period beginning on July 1, 1985, even if the alternate Federal rate is greater than 10 percent for any or all of the four remaining months in the semiannual period ending on December 31, 1985.

(d) *Short periods.* The rules for determining whether a loan has sufficient stated interest also apply to short periods (*e.g.*, a period that is shorter than the interval between interest payments or interest compounding under the loan which may occur at the beginning or end of the loan). For special computational rules and examples relating to a short periods, see § 1.7872–12.

(e) *Variable rates of interest*—(1) *In general.* If a loan requires payments of interest calculated at a rate of interest based in whole or in part on an objective index or combination of indices of market interest rates (*e.g.*, a prime rate, the applicable Federal rate, the average yield on government securities as reflected in the weekly Treasury bill rate, the Treasury constant maturity series, or LIBOR (London interbank offered rate)), the loan will be treated as having sufficient stated interest if—

(i) In the case of a term loan, the rate fixed by the index or indices is no lower than the applicable Federal rate, as determined under paragraph (b)(4) of this section (as modified by paragraph (e)(2) of this section), on the date the loan in made; or

(ii) In the case of a demand loan, the interest rate fixed by the index or indices is no lower than the applicable Federal rate, as determined under paragraph (b)(3) of this section, for each semiannual period that the loan is outstanding. See paragraph (e)(2)(i) of this section for rules relating to variable interest rate demand loans the interest rates of which are tied to the applicable Federal rate.

(2) *Special rules*—(i) *Demand loans tied to the applicable Federal rate.* A variable rate demand loan will be

treated as having sufficient stated interest if, by the terms of the loan agreement, the interest rate cannot be less than the lower of the Federal statutory short-term rate or the alternate Federal short-term rate in effect at the beginning (or, if the agreement so provides, at the end) of the payment or compounding period (whichever is shorter).

(ii) *Applicable Federal rate for variable interest rate term loans.* For purposes of determining the applicable Federal rate, if a term loan requires payments or compounding of interest based on a variable rate (within the meaning of paragraph (e)(1) of this section), the term of the loan shall be treated as being equal to the longest period of time that exists between the dates that, under the loan agreement, the interest rate charged on the loan is required to be recomputed (whether or not the recomputation results in a rate different from the immediately preceding rate). Thus, for example, in the case of a 10 year term loan that charges interest at a variable rate equal to a rate 2 points above the prime rate, and that requires that the interest rate be adjusted every 18 months to reflect any changes in the prime rate, the applicable Federal rate is determined by treating the loan as having a term of 18 months rather than a term of 10 years. Accordingly, the applicable Federal short-term rate rather than the applicable Federal long-term rate shall apply.

(3) The provision of paragraph (e)(1) of this section may be illustrated by the following examples:

Example (1). On April 1, 1985, A loans $200,000 to B, repayable on demand. The note calls for interest to be paid semiannually on September 30 and March 31 of each year at a rate equal to the alternate Federal short-term rate (based on semiannual compounding) for the month in which the payment is made. The loan has sufficient stated interest.

Example (2). Assume the same facts as in *Example (1)* except that the note calls for interest at a rate equal to the lower of the alternate Federal short-term rate or the statutory Federal short-term rate (in each case, based on semiannual compounding) for the month in which the payment is made. The loan has sufficient stated interest.

Example (3). Assume the same facts as in *Example (1)* except that interest is computed and compounded at the end of each month at a rate equal to the lower of the alternate Federal short-term rate of the statutory Federal short-term rate (in each case, based on monthly compounding) in effect for that month. Accrued interest is payable semiannually on September 20 and March 31 of each year. The loan has sufficient stated interest.

Example (4). Assume the same facts as in *Example (1)* except that interest is payable at the prime rate of a major lending institution at the time each payment is made. The prime rate is not an index which by its terms cannot be less than the lower of the statutory Federal short-term rate of the alternate Federal short-term rate. Therefore, the loan will be tested for sufficient stated interest in each semiannual period under the rules of paragraph (b)(3) of this section.

(f) *Contingent interest.* [Reserved]

§ 1.7872–4 Types of below-market loans.

(a) *In general.* Section 7872 applies only to certain categories of below-market loans. These categories are gift loans, compensation-related loans, corporation-shareholder loans, tax avoidance loans, and certain other loans classified in the regulations under section 7872 as significant tax effect loans (*i.e.*, loans whose interest arrangements have a significant effect on any Federal tax liability of the lender or the borrower.)

(b) *Gift loans*—(1) *In general.* The term "gift loan" means any below-market loan in which the foregoing of interest is in the nature of a gift within the meaning of Chapter 12 of the Internal Revenue Code (whether or not the lender is a natural person).

(2) *Cross reference.* See § 1.7872–8 for special rules limiting the application of section 7872 to gift loans. See paragraph (g) of this section for rules with respect to below-market loans which are indirectly gift loans.

(c) *Compensation-related loans*—(1) *In general.* A compensation-related loan is a below-market loan that is made in connection with the performance of services, directly or indirectly, between—

(i) An employer and an employee,

(ii) An independent contractor and a person for whom such independent contractor provides services, or

(iii) A partnership and a partner if the loan is made in consideration for services performed by the partner acting other than in his capacity as a member of the partnership.

The imputed transfer (amount of money treated as transferred) by the lender to the borrower is compensation. For purposes of this section, the term "in connection with the performance of services" has the same meaning as the term has for purposes of section 83. A loan from a qualified pension, profit-sharing, or stock bonus plan to a participant of the plan is not, directly or indirectly, a compensation-related loan.

(2) *Loan in part in exchange for services.* Except as provided in paragraph (d)(2) of this section (relating to a loan from a corporation to an employee who is also a shareholder of the corporation), a loan which is made in part in exchange for services and in part for other reasons is treated as a compensation-related loan for purposes of section 7872(c)(3) only if more than 25 percent of the amount loaned is attributable to the performance of services. If 25 percent or less of the amount loaned is attributable to the performance of services, the loan is not subject to section 7872 by reason of being a compensation-related loan. The loan may, however, be subject to section 7872 by reason of being a below-market loan characterized other than as a compensation-related loan (*e.g.*, corporation-shareholder loan or tax avoidance loan). If—

(i) A loan is characterized as a "compensation-related" loan under this paragraph (c),

(ii) Less than 100 percent of the amount loaned is attributable to the performance of services, and

(iii) The portion of the amount loaned that is not attributable to the performance of services is not subject to section 7872, then the amounts of imputed transfer (as defined in § 1.7872–1(a)(2)) and imputed transfer (as defined in § 1.7872–1(a)) are determined only with respect to that part of the loan which is attributable to services. All of the facts and circumstances surrounding the loan agreement and the relationship between the lender and the borrower are taken into account in determining the portion of the loan made in exchange for services.

(3) *Third-party lender as agent.* A below-market loan by an unrelated third-party lender to an employee is treated as attributable to the performance of services if, taking into account all the facts and circumstances, the transaction is in substance a loan by the employer made with the aid of a third-party lender acting as an agent of the employer. Among the facts and circumstances which indicate whether such a loan has been made is whether the employer bears the risk of default at and immediately after the time the loan is made. The principles of this paragraph (c)(3) also apply with respect to a below-market loan by an unrelated third-party lender to an independent contractor.

(4) *Special rule for continuing care facilities.* Any loan to a continuing care facility will not be treated, in whole or in part, as a compensation-related loan.

(5) *Cross-references.* For a special rule in the case of a below-market loan that could be characterized as both a compensation-related loan and a corporation-shareholder loan, see paragraph (d)(2) of this section. See paragraph (g) of this section for rules with respect to below-market loans

which are indirectly compensation-related loans.

(d) *Corporation-shareholder loans*—(1) *In general.* A below-market loan is a corporation-shareholder loan if the loan is made directly or indirectly between a corporation and any shareholder of the corporation. The amount of money treated as transferred by the lender to the borrower is a distribution of money (characterized according to section 301 or in the case of an S corporation, section 1368) if the corporation is the lender, or a contribution to capital if the shareholder is the lender.

(2) *Special rule.* A below-market loan—

(i) From a publicly held corporation to an employee of the corporation who is also a shareholder owning directly or indirectly more than 0.5 percent of the total voting power of all classes of stock entitled to vote or more than 0.5 percent of the total value of shares of all other classes of stock or 0.5 percent of the total value of shares of all classes of stock (including voting stock) of the corporation; or

(ii) From a corporation that is not a publicly held corporation to an employee of the corporation who is also a shareholder owning directly or indirectly more than 5 percent of the total voting power of all classes of stock entitled to vote or more than 5 percent of the total number of shares of all other classes of stock or 5 percent of the total value of shares of all classes of stock (including voting stock) of the corporation; will be presumed to be a corporation-shareholder loan, in the absence of clear and convincing evidence that the loan is made solely in connection with the performance of services. For purposes of determining the percentage of direct and indirect stock ownership, the constructive ownership rules of section 267(c) apply.

(3) *Cross-reference.* See paragraph (g) of this section for rules with respect to below-market loans which are indirectly corporation-shareholder loans.

(e) *Tax avoidance loans.* A tax avoidance loan is any below-market loan one of the principal purposes for the interest arrangements of which is the avoidance of Federal tax with respect to either the borrower or the lender, or both. For purposes of this rule, tax avoidance is a principal purpose of the interest arrangements if a principal factor in the decision to structure the transaction as a below-market loan (rather than, for example, as a market interest rate loan and a payment by the lender to the borrower) is to reduce the Federal tax liability of the borrower or the lender or both. The purpose for entering into the transaction (for example, to a make a gift or to pay compensation) is irrelevant in determining whether a principal purpose of the interest arrangements of the loan is the avoidance of Federal tax.

(f) *Certain below-market loans with significant effect on tax liability ("significant-effect" loans)*—[Reserved].

(g) *Indirect loans*—(1) *In general.* If a below-market loan is made between two persons and, based on all the facts and circumstances, the effect of the loan is to make a gift or a capital contribution or a distribution of money (under section 301 or in the case of an S corporation, section 1368), or to pay compensation to a third person ("indirect participant"), or is otherwise attributable to the relationship of the lender or borrower to the indirect participant, the loan is restructured as two or more successive below-market loans ("deemed loans") for purposes of section 7872, as follows:

(i) A deemed below-market loan made by the named lender to the indirect participant; and

(ii) A deemed below-market loan made by the indirect participant to the borrower. Section 7872 is applied separately to each deemed loan, and each deemed loan is treated as having the same provisions as the original loan between the lender and the borrower. Thus, for example, if a father makes an interest-free loan to his daughter's corporation, the loan is restructured as a below-market loan from father to daughter (deemed gift loan) and a second below-market loan from daughter to corporation (deemed corporation-shareholder loan). Similarly, if a corporation makes an interest-free loan to another commonly controlled corporation, the loan is restructured as a below-market loan from the lending corporation to the common parent corporation and a second below-market loan from the parent corporation to the borrowing corporation.

(2) *Special rule for intermediaries.* If a lender and a borrower use another person, such as an individual, a trust, a partnership, or a corporation, as an intermediary or middleman in a loan transaction and a purpose for such use is to avoid the application of section 7872(c)(1) (A), (B), or (C), the intermediary will be ignored and the loan will be treated as made directly between the lender and the borrower. Thus, for example, if a father and a son arrange their below-market loan transaction by having the father make a below-market loan to the father's partnership, followed by a second below-market loan (with substantially identical terms and conditions as the first loan) made by the partnership to the son, the two below-market loans will be restructured as one below-market loan from the father to the son.

§ 1.7872-5 Exempted loans.

(a) *In general*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, notwithstanding any other provision of section 7872 and the regulations thereunder, section 7872 does not apply to the loans listed in paragraph (b) of this section because the interest arrangements do not have a significant effect on the Federal tax liability of the borrower or the lender.

(2) *No exemption for tax avoidance loans.* If a taxpayer structures a transaction to be a loan described in paragraph (b) of this section and one of the principal purposes of so structuring the transaction is the avoidance of Federal tax, then the transaction will be recharacterized as a tax avoidance loan as defined in section 7872(c)(1)(D).

(b) *List of exemptions.* Except as provided in paragraph (a) of this section, the following transactions are exempt from section 7872:

(1) Loans which are made available by the lender to the general public on the same terms and conditions and which are consistent with the lender's customary business practices;

(2) Accounts or withdrawable shares with a bank (as defined in section 581), or an institution to which section 591 applies, or a credit union, made in the ordinary course of its business;

(3) Acquisitions of publicly traded debt obligations for an amount equal to the public trading price at the time of acquisition;

(4) Loans made by a life insurance company (as defined in section 816(a)), in the ordinary course of its business, to an insured, under a loan right contained in a life insurance policy and in which the cash surrender values are used as collateral for the loans;

(5) Loans subsidized by the Federal, State (including the District of Columbia), or Municipal government (or any agency or instrumentality thereof), and which are made available under a program of general application to the public;

(6) Employee-relocation loans that meet the requirements of paragraph (c)(1) of this section;

(7) Obligations the interest on which is excluded from gross income under section 103;

(8) Obligations of the United States government;

(9) Loans to a charitable organization (described in section 170(c)), but only if at no time during the taxable year will the aggregate outstanding amount of

loans by the lender to all such organizations exceed $10,000;

(10) Loans made to or from a foreign person that meet the requirements of paragraph (c)(2) of this section;

(11) Loans made by a private foundation or other organization described in section 170(c), the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B);

(12) Loans made prior to July 1, 1986, to the extent excepted from the application of section 482 for the 6-month (or longer) period referred to in § 1.482-2(a)(3);

(13) For periods prior to July 1, 1986, all money, securities, and property received by a futures commission merchant or by a clearing organization (i) to margin, guarantee or secure contracts for future delivery on or subject to the rules of a qualified board or exchange (as defined in section 1256(g)(7)), or (ii) to purchase, margin, guarantee or secure options contracts traded on or subject to the rules of a qualified board or exchange, and all money accruing to account holders as the result of such futures and options contracts;

(14) Loans where the taxpayer can show that the below market interest arrangements have no significant effect on any Federal tax liability of the lender or the borrower, as described in paragraph (c)(3) of this section; and

(15) Loans, described in revenue rulings or revenue procedures issued under section 7872(g)(1)(C), if the Commissioner finds that the factors justifying an exemption for such loans are sufficiently similar to the factors justifying the exemptions contained in this section.

(c) *Special rules*—(1) *Employee-relocation loans*—(i) *Mortgage loans.* In the case of a compensation-related loan to an employee, where such loan is secured by a mortgage on the new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee, acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The loan is a demand loan or is a term loan the benefits of the interest arrangements of which are not transferable by the employee and are conditioned on the future performance of substantial services by the employee;

(B) The employee certifies to the employer that the employee reasonably expects to be entitled to and will itemize deductions for each year the loan is outstanding; and

(C) The loan agreement requires that the loan proceeds be used only to purchase the new principal residence of the employee.

(ii) *Bridge loans.* In the case of a compensation-related loan to an employee which is not described in paragraph (c)(1)(i) of this section, and which is used to purchase a new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The conditions contained in paragraphs (c)(1)(i)(A), (B), and (C) of this section;

(B) The loan agreement provides that the loan is payable in full within 15 days after the date of the sale of the employee's immediately former principal residence;

(C) The aggregate principal amount of all outstanding loans described in this paragraph (c)(1)(ii) to an employee is no greater than the employer's reasonable estimate of the amount of the equity of the employee and the employee's spouse in the employee's immediately former principal residence, and

(D) The employee's immediately former principal residence is not converted to business or investment use.

(2) *Below-market loans involving foreign persons*—(i) Section 7872 shall not apply to a below-market loan (other than a compensation-related loan or a corporation-shareholder loan where the borrower is a shareholder that is not a C corporation as defined in section 1361(a)(2)) if the lender is a foreign person and the borrower is a U.S. person, unless the interest income imputed to the foreign lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(ii) Section 7872 shall not apply to a below-market loan where both the lender and the borrower are foreign persons unless the interest income imputed to the lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(iii) For purposes of this section, the term "foreign person" means any person that is not a U.S. person.

(3) *Loans without significant tax effect.* Whether a loan will be considered to be a loan the interest arrangements of which have a significant effect on any Federal tax liability of the lender or the borrower will be determined according to all of the facts and circumstances. Among the factors to be considered are—

(i) Whether items of income and deduction generated by the loan offset each other;

(ii) The amount of such items;

(iii) The cost to the taxpayer of complying with the provisions of section 7872 if such section were applied, and

(iv) Any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

§ 1.7872-6 Timing and amount of transfers in connection with gift loans and demand loans.

(a) *In general.* Section 7872(a) and the provisions of this section govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender in the case of a below-market demand loan. Section 7872(a) and this section also govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender from income tax purposes in the case of term gift loans. (See section 7872(b), 7872(d)(2), and § 1.7872-7 for rules governing the timing and the amount of the imputed transfer by the lender to the borrower in the case of term gift loans for gift tax purposes.) Section 7872(d)(1) and § 1.7872-8 limit the amount of the imputed interest payment with respect to certain gift loans. See § 1.7872-10(a) for rules for distinguishing demand loans from term loans. See 1.7872-11(f) for special rules governing loans repayable in foreign currency, which apply notwithstanding any contrary rules set forth in this section.

(b) *Time of transfer*—(1) *In general.* Except as otherwise provided in paragraphs (b) (3), (4), and (5) of this section, the foregone interest (as defined in section 7872(e)(2) and paragraph (c) of this section) attributable to periods during any calendar year is treated as transferred by the lender to the borrower (and retransferred by the

borrower to the lender) on December 31 of that calendar year and shall be treated for tax purposes in a manner consistent with the taxpayer's method of accounting.

(2) *Example.* Paragraph (b)(1) of this section may be illustrated by the following example.

Example. On January 1, 1985, E makes a $200,000 interest-free demand loan to F, an employee of E. The loan remains outstanding for the entire 1985 calendar year. E has a taxable year ending September 30. F is a calendar year taxpayer. For 1985, the imputed compensation payment and the imputed interest payment (as computed under paragraph (c) of this section) are treated as made on December 31.

(3) *Gift loans between natural persons.* In the case of gift loans directly between natural persons within the meaning of § 1.7872–8(a)(2), any imputed transfer and any imputed interest payment to which this section applies during the borrower's taxable year is treated, for both the lender and the borrower, as occurring on the last day of the borrower's taxable year.

(4) *Death, liquidation or termination of borrower.* If the borrower dies (in the case of a borrower who is a natural person) or is liquidated or otherwise terminated (in the case of a borrower other than a natural person), any imputed transfer and any imputed interest payment arising during the borrower's final taxable year are treated, for both the lender and the borrower as occurring on the last day of the borrower's final taxable year.

(5) *Repayment of loan.* If a below-market loan is repaid, any imputed transfer and any imputed interest payment arising during the borrower's taxable year which includes the date of repayment is treated, for both the lender and the borrower, as occurring on the day the loan is repaid.

(c) *Amount of transfer.* In the case of a below-market loan to which section 7872 applies and which is a demand loan (including a term loan that is treated as a demand loan as provided in section § 1.7872–10(a)(5)) or a gift term loan, the foregone interest (as computed under the provisions of § 1.7872–13) with respect to the loan is treated as transferred by the lender to the borrower and retransferred as interest by the borrower to the lender. Generally, for any calendar year the term "foregone interest" means the excess of—

(1) The amount of interest that would have been payable in that year if interest had accrued at the applicable Federal rate (as determined in § 1.7872–13); over

(2) Any interest payable on the loan properly allocable to that year.

The amount of foregone interest is computed for each day during the period for which section 7872(a) applies to the loan and is treated as transferred and retransferred on the data specified in paragraph (b) of this section.

§ 1.7872–7 Timing and amount of transfers in connection with below-market term loans.

(a) *In General.* This section governs the Federal income tax consequences of below-market term loans, other than gift term loans or term loans treated as demand loans under the provisions of § 1.7872–10(a)(5), to which section 7872 applies. It also governs the Federal gift tax consequences of below-market gift term loans. See § 1.7872–11(f) for special rules which govern loans repayable in foreign currency and which apply notwithstanding any contrary rules set forth in this section.

(1) *Timing and amount of transfer from lender to borrower.* In the case of term loans to which this section applies, the amount of the imputed transfer by the lender to the borrower—

(i) Is treated as transferred at the time the loan is made and is treated for tax purposes in a manner consistent with the taxpayer's method of accounting; and

(ii) Is equal to the excess of—

(A) The amount loaned (as defined in paragraph (a)(4) of this section); over

(B) The present value (as determined in paragraph (a)(5) of this section and § 1.7872–14) of all payments which are required to be made under the terms of the loan agreement, whether express or implied.

(2) *Gift term loans.* In the case of a gift term loan, the rules of paragraph (a)(1) of this section apply for gift tax purposes only. For rules governing the income tax consequences of gift term loans, see § 1.7872–6.

(3) Treatment of amount equal to imputed transfer as original issue discount—(i) *In general.* Any below-market loan to which paragraph (a)(1) of this section applies shall be treated as having original issue discount in an amount equal to the amount of the imputed transfer determined under paragraph (a)(1) of this section. This imputed original issue discount is in addition to any other original issue discount on the loan (determined without regard to section 7872(b) or this paragraph). For purposes of applying section 1272 to a loan described in this paragraph, the issue price shall be treated as equal to the stated principal reduced by the amount of the imputed transfer and the yield to maturity is the applicable Federal rate.

(ii) *Example.* The provisions of this paragraph (a)(3) may be illustrated by the following example.

Example. (i) On June 10, 1984, L lends $45,000 to B, a corporation in which L is a shareholder, for five years in exchange for a $50,000 note bearing interest at a below-market rate. Assume that the present value of all payments that B must make to L is $42,000. This loan is a corporation-shareholder term loan under section 7872(c)(1)(C). Accordingly, the amount of the imputed transfer by L to B is determined under the provisions of section 7872(b).

(ii) On June 10, 1984, L is treated as transferring $3,000 (the excess of $45,000 (amount loaned) over $42,000 (present value of all payments)), in accordance with section 7872(b)(1). This imputed transfer is treated as a contribution to B's capital by L. An amount equal to the imputed transfer is treated as original issue discount. This original issue discount is in addition to the $5,000 ($50,000, the stated redemption price, less $45,000, the issue price) of original issue discount otherwise determined under section 1273. As a result, the loan is treated as having a total of $8,000 of original issue discount.

(4) *Amount loaned.* The term "amount loaned" means the amount received by the borrower (determined without regard to section 7872). See § 1.7872–2(a)(3) for the treatment of the transfer of the loan proceeds to the borrower in installments or subject to draw-down restrictions.

(5) *Present value.* The present value of all payments which are required to be made under the provisions of the loan agreement is computed as of the date the loan is made (or, if later, as of the day the loan first becomes subject to the provisions of section 7872). The discount rate for the present value computation is the applicable Federal rate as defined in § 1.7872–3(b) in effect on the day on which the loan is made. For rules governing the computation of present value, see § 1.7872–14. See also *Example (3)* in § 1.7872–8(b)(5).

(6) *Basis.* In the case of a term loan the lender's basis in the note received in exchange for lending money is equal to the present value of all payments which are required to be made under the terms of the loan agreement, whether express or implied, with adjustments as provided for in section 1272(d)(2).

(b) *Special rule for the de minimis provisions*—(1) *In general.* If as a result of the application of the *de minimis* provisions of section 7872(c) (2) or (3), a loan become subject to section 7872 and this section on a day after the day on which the loan is made, the provisions of this section generally apply to the loan as if the loan were made on that

later day. The applicable Federal rate applied to this loan (including for purposes of computing the present value of the loan), however, is the applicable Federal rate (as defined in § 1.7872-3(b)) in effect on the day on which the loan is first made. The present value computation described in paragraph (a)(1)(ii)(B) of this section is made as of the day on which section 7872 and this section first apply to the loan. For purposes of making this computation, the term of the loan is equal to the period beginning on the day that section 7872 first applies to the loan and ending on the day on which the loan is to be repaid according to the loan agreement. Any payments payable according to the loan agreement before the day on which section 7872 and this section first apply to the loans are disregarded.

(2) *Continuing application of section 7872.* Once section 7872 and this section apply to a term loan, they continue to apply to the loan regardless of whether the *de minimis* provisions of section 7872(c) (2) or (3) apply at some later date. In the case of a gift term loan, this paragraph applies only for gift tax purposes and does not apply for income tax purposes.

§ 1.7872-8 Special rules for gift loans directly between natural persons.

(a) *Special rules for gift loans directly between natural persons*—(1) *In general.* Section 7872 (c)(2) and (d) apply special rules to gift loans directly between natural persons if the aggregate outstanding amount of loans (as determined in pargraph (b)(2) of this section) between those natural persons does not exceed specified limitations.

(2) *Loans directly between natural persons*—(i) For purposes of this section, a loan is made directly between natural persons only if both the lender and borrower are natural persons. For this purpose, a loan by a natural person lender to the guardian (or custodian, in the case of a gift made pursuant to the Uniform Gift to Minors Act) of a natural person is treated as a loan directly between natural persons. If, however, a parent lends money to a trust of which the child is the sole beneficiary, the loan is not treated as directly between natural persons for purposes of this section.

(ii) A gift loan which results from restructuring an indirect loan as two or more loans (as described in § 1.7872-4(g)) and in which natural persons are deemed to be the lender and the borrower is treated as a loan directly between natural persons. Thus, for example, if an employer makes a below-market loan to an employee's child, the loan is restructured as one loan from the employer to the employee, and a second loan from the employee to his child. The deemed gift loan between the employee and the employee's child is treated as directly between natural persons.

(b) *De minimis exception*—(1) *In general.* Except as otherwise provided in paragraph (b)(3) of this section or in § 1.7872-7(a) (with respect to the gift tax consequences of a gift term loan to which the provisions of section 7872 have already been applied), in the case of any gift loan directly between natural persons, the provisions of section 7872 do not apply to any loan outstanding on any day on which the aggregate outstanding amount of loans between the lender and borrower does not exceed $10,000. The *de minimis* rule of this paragraph (b)(1) applies with respect to a gift loan even though that loan could also be characterized as a tax avoidance loan within the meaning of section 7872(c)(1)(D) and § 1.7872-4(e).

(2) *Aggregate outstanding amount of loans.* The aggregate outstanding amount of loans between natural persons is the sum of the principal amounts of outstanding loans directly between the individuals, regardless of the character of the loans, regardless of the interest rate charged on the loans, and regardless of the date on which the loans were made. For this purpose, the principal amount of a loan which is also subject to section 1272 (without applying the limitation of section 1273(a)(3)) is the "adjusted issue price" as that term is defined in section 1272(a)(4). See § 1.7872-7(a)(3)(i) for the determination of the issue price of a loan which is also subject to section 1272.

(3) *Loans attributable to acquisition or carrying of income-producing assets.* The *de minimis* exception described in paragraph (b)(1) of this section does not apply to any gift loan directly attributable to the purchase or carrying of income-producing assets. A gift loan is directly attributable to the purchase or carrying of income-producing assets, for example, if the loan proceeds are directly traceable to the purchase of the income-producing assets, the assets are used as collateral for the loan, or there is direct evidence that the loan was made to avoid disposition of the assets.

(4) *Income-producing assets.* For purposes of this paragraph (b), the term "income-producing asset" means (i) an asset of a type that generates ordinary income, or, (ii) a market discount bond issued before July 19, 1984. Accordingly, an income producing asset includes, but is not limited to, a business, a certificate of deposit, a savings account, stock (whether or not dividends are paid), bonds and rental property.

(5) *Examples.* The provisions of this paragraph (b) may be illustrated by the following examples.

Example (1). (i) As of January 1, 1985, the total aggregate outstanding amount of loans by Parent P, to child, C, is $6,000. None of these loans is a below-market loan. On February 1, 1985, P makes a $3,000 below-market demand loan to C. On March 1, 1985, P makes a $2,000 below-market demand loan to C. On November 1, 1985, C repays $1,500 of principal of the market-rate loans to P; all of the other loans remain outstanding as of December 31, 1985. The below-market loans are gift loans and are the only new loans between P and C for calendar year 1985.

(ii) For the periods January 1, 1985, through Febraury 28, 1985, and November 1, 1985, through December 31, 1985, section 7872 does not apply to the loans between P and C because the outstanding loan balance between P and C does not exceed $10,000 during these periods. For the period beginning on March 1, 1985, and ending on October 31, 1985, however, the aggregate outstanding amount of loans directly between P and C exceeds $10,000. Accordingly, the provisions of section 7872(a) apply to the $3,000 gift loan and $2,000 gift loan during that period.

Example (2). (i) Assume the same facts as in Example (1) except that the $2,000 gift loan made on March 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the $3,000 gift demand loan made on February 1, 1985, are the same as in Example (1).

(ii) With respect to the $2,000 gift term loan, section 7872(b)(1) applies beginning on March 1, 1985, for purposes of computing the amount on the imputed gift by P to C. For the period beginning on March 1, 1985, and ending on October 31, 1985, section 7872(a) applies to the $2,000 gift term loan for purposes of determining the amount and the timing of the imputed interest payment by C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the $2,000 loan for Federal income tax purposes because the outstanding loan balance between P and C does not exceed $10,000 during this period.

Example (3). (i) Assume the same facts as in Example (1) except that the $3,000 gift loan made on February 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the $2,000 demand gift loan made on March 1, 1985, are identical to those in Example (1).

(ii) On February 1, 1985, section 7872 does not apply to the $3,000 loan because the outstanding loan balance between P and C does not exceed $10,000. On March 1, 1985, however, the aggregate outstanding amount of loans between P and C exceeds $10,000. For Federal gift tax purposes, section 7872(b)(1) applies to the $3,000 loan beginning on March 1, 1985. Under § 1.7872-7(b), the provisions of section 7872 apply to the loan had been made on March 1, 1985. See § 1.7872-7(a)(5) for special rules for computing the present value of payments due on the loan. For the eight-month period beginning on March 1, 1985, section 7872(a) applies to the $3,000 loan for purposes of determining the imputed interest payment by

C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the $3,000 loan for Federal income tax purposes because of the application of the *de minimis* provisions.

Example (4). On June 10, 1984, parent L makes an $8,000 interest-free gift term loan to L's child, B. This is the only loan outstanding between L and B during 1984. On June 11, 1984, B invests the $8,000 in corporate stock. The $10,000 *de minimis* provision does not apply to the loan, because the loan proceeds are directly attributable to the purchase of corporate stock, an income-producing asset.

(c) *Limitation on amount of imputed interest payment*—(1) *In general.* In the case of a loan between a borrower and a lender both of whom are natural persons (within the meaning of paragraph (a)(2) of this section), for all days during the borrower's taxable year on which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and the lender, is $100,000 or less, the amount of the imputed interest payment by the borrower to the lender with respect to any gift loan is limited to the borrower's net investment income (as determined under paragraph (c)(7) of this section) for the taxable year. This paragraph (c) does not affect the gift tax consequences of any loan under section 7872.

(2) *Tax avoidance loan.* Paragraph (c)(1) of this section does not apply to any loan which is a tax avoidance loan within the meaning of § 1.7872-4(e).

(3) *No limitation if investment income is manipulated.* Paragraph (c)(1) of this section does not apply if a borrower can control the timing of the receipt of investment income and actually does manipulate the timing to accelerate or defer the receipt of investment income. For example, if the borrower can, and actually does, control the timing of dividends paid by a closely held corporation, the limitation on the amount of the imputed interest payment does not apply.

(4) *Net investment income of $1,000 or less disregarded.* If paragraph (c)(1) of this section applies and if the borrower's net investment income (as determined under paragraph (c)(7) of this section) for a taxable year is $1,000 or less, the borrower's net investment income for that year is deemed to be zero for purposes of this paragraph (c).

(5) *No proration of net investment income.* The entire amount of the borrower's net investment income for a taxable year (as determined under paragraph (c)(7) of this section) is taken into account in determining the maximum imputed interest payment for those days during the year on which the net investment income limitation applies. Accordingly, the amount of net investment income is not allocated among the days of the borrower's taxable year. Further, for a taxable year of a borrower which ends after June 6, 1984, and includes any day or days before June 7, 1984, the entire amount of net investment income for the taxable year is taken into account in determining the maximum imputed interest payment for the days during that year on which the limitation applies.

(6) *Allocation among gift loans.* In the case of a borrower who has more than one gift loan outstanding during a taxable year, the borrower's net investment income for that year is allocated among the gift loans in proporation to the respective amounts which would be treated as imputed interest payments by the borrower to the lender or lenders with respect to those loans without regard to this paragraph (c). (See Example (2) of paragraph (c)(9) of this section.) No amount of the net investment income is allocable to any gift loan between the lender and the borrower for periods during which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and that lender exceeds $100,000.

(7) *Amounts included in net investment income.* For purposes of section 7872, net investment income for a taxable year equals the sum of—

(i) Net investment income for that year as determined under section 163(d)(3), excluding any item of income on a deferred payment obligation which is treated under section 7872(d)(1)(E)(iii) and paragraph (c)(7)(ii) of this section as interest received in a prior taxable year ending after June 6, 1984, and

(ii) The amount that is treated under section 7872(d)(1)(E) (iii) as interest received for that year on a deferred payment obligation.

(8) *Deferred payment obligation.* The term "deffered payment obligation" means a market discount bond issued before July 18, 1984, or an obligation that, if held to maturity, would produce a predictable and regular flow of ordinary income which, under applicable tax rules, is not recognized until a subsequent period. Accordingly, deferred payment obligations include, but are not limited to, those obligations listed in section 7872(d)(1)(E)(iv).

(9) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). On January 1, 1985, parent P makes a $50,000 below-market gift loan to C. P's child, who uses the calender year as the taxable year. On March 1, 1985, P makes an additional $75,000 market-rate loan to C. On October 1, 1985, C repays $30,000 of the market rate loan. Assume that C's net investment income (as determined under paragraph (c)(7) of this section) for 1985 is $2,400. The limitation under section 7872(d)(1) on the amount of imputed interest payment applies to the $50,000 loans for the two-month period beginning on January 1, 1985, and the three-month period beginning on October 1, 1985. Accordingly, the imputed interest payment on the $50,000 loan for 1985 may not exceed $2,400.

Example (2). During 1985, natural person borrower B has three gift loans outstanding, each from a different lender. Each loan is eligible for the entire year for the special limitation on the amount of imputed interest payments under section 7872(d)(1) but none of the loans is eligible for the de minimis exception of pargraph (b) of this section. B's net investment income for 1985 is $9,000. The aggregate imputed interest payments on these loans (determmined without regard to section 7872(d)(1)) would be $9,000. The amount of imputed interest attributable to each loan after application of section 7872(d)(1) is computed as follows:

Loan	Imputed interest payments (before application of section 7872(d)(1))	Relative share of net investment income (imputed interest payment after application of section 7872(d)(1))	
1	$3,000	$2,000	($6,000 × $3,000/$9,000)
2	4,000	2,667	($6,000 × $4,000/$8,000)
3	2,000	1,333	($6,000 × $2,000/$9,000)
Total	9,000	6,000	

Consequently, the imputed interest payment to lander 1 cannot exceed $2,000; the imputed interest payment to lender 2 cannot exceed $2,667; and, the imputed interest payment to lender 3 cannot exceed $1,333.

§ 1.7872-9 De minimis exception for compensation-related or corporation-shareholder loans.

(a) *In general.* In the case of any demand loan described in section 7872(c)(1) (B) or (C), the provisions of section 7872 do not apply to any day on which the aggregate outstanding amount of loans between the lender and the borrower does not exceed $10,000. In the case of any term loan described in section 7872(c)(1) (B) or (C) (relating to the *de minimis* rules), the provisions of section 7872 apply to the loan as of the first day on which the aggregate outstanding amount of loans between the lender and the borrower exceeds $10,000. Once section 7872 applies to a term loan, section 7872 continues to apply to the loan regardless of whether the $10,000 limitation applies at some later date.

(b) *Aggregate outstanding amount of loans.* The aggregate outstanding amount of loans between the lender and the borrower is the sum of the principal

amounts of outstanding loans directly between the parties, regardless of the character of the loans, regardless of the interest rate charged on the loans, and regardless of the date on which the loans were made. For this purpose, the principal amount of a loan which is also subject to section 1272 (without applying the limitation of section 1273(a)(3)) is the " adjusted issue price" as that term is defined in section 1272(a)(4). See § 1.7872–7(a)(3)(i) for the determination of the issue price of a loan which is also subject to section 7872.

(c) *Tax avoidance loan.* This section does not apply to any loan which is a tax avoidance loan within the meaning of § 1.7872–4(e).

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. (i) On January 1, 1985, L made a $4,000 four-year term loan to B, a corporation in which L is a shareholder. On October 15, 1986, L made a $7,000 five-year term loan to B. Both loans are interest-free and are payable on the last day of the loan term. There are no other outstanding loan between L and B. Neither loan is a tax avoidance loan.

(ii) For the period beginning on January 1, 1985 and ending on October 14, 1986, the provisions of section 7872 do not apply to the $4,000 loan because the outstanding loan balance between L and B does not exceed $10,000. On October 15, 1986, however, the aggregate amount of loans between L and B exceeds $10,000. Accordingly, the provisions of section 7872(b) apply to both loans. See § 1.7872–4(d) for the proper Federal tax treatment of the imputed transfer by L to B. For purposes of computing the present value of all payments to be made under the loan agreements, the applicable Federal rate for the $4,000 loan is the applicable Federal rate in effect on January 1, 1985, for loans with a term of 4 years (even though less than three years remain before the loan ends). Under § 1.7872–7(b), the present value of the payment to be made under the $4,000 loan agreement is determined as of October 15, 1986 (the date on which section 7872 first applies to the $4,000 loan) for a loan with a term which begins on October 15, 1986, and ends on January 1, 1989.

§ 1.7872–10 Other definitions.

(a) *"Term" and "demand" loans distinguished.* For purposes of section 7872—

(1) *Demand loan.* Any loan which is payable in full at any time on the demand of the lender (or within a reasonable time after the lender's demand), is a "demand loan."

(2) *Term loan.* A loan is treated as a "term loan" if the loan agreement specifies an ascertainable period of time during which the loan is to be outstanding. For purposes of this rule, a period of time is treated as being ascertainable if the period may be determined actuarially. Thus, a loan agreement which provides that D loans E $16,000 for E's life, will be treated as a term loan because the life expectancy of E may be determined actuarilly.

(3) *Acceleration and extension clauses.* Acceleration clauses and similar provisions that would make a loan due before the time otherwise specified including provisions permitting prepayment of a loan or accelerating the maturity date on disposition of collateral ("due on sale" clauses) are disregarded for purposes of section 7872. Thus, a loan for a term of 15 years is a term loan for 15 years even if it is subject to acceleration upon some action of the borrower. If the loan agreement specifies an ascertainable period of time during which the loan is to be outstanding but contains an extension clause or similar provision that would make the loan due after the time otherwise specified, the loan is a term loan during the ascertainable period and a second demand or term loan thereafter; the classification of the second loan as term or demand depends upon the terms of the extension clause.

(4) *Loans for a period of time not ascertainable.* [Reserved]

(5) *Certain loans conditioned on future services.* For all purposes of section 7872 other than determining the applicable Federal rate (see, § 1.7872–3(b)), if the benefits of the interest arrangements of a term loan are not transferable by the individual borrower and are conditoned on the future performance of substantial services by the individual borrower (within the meaning of section 83), the loan is treated as a demand loan. All facts and circumstances must be examined to determine whether the future services to be performed are substantial.

(6) *Revolving credit loans.* For purposes of section 7872, an extension of credit by reason of the use of a credit card that is available to a borad segment of the general public is treated as a demand loan, and the provisions of section 7872 may apply if the loan is described in one of the categories set forth in § 1.7872–4. The period during which the loan is outstanding begins on the first day on which a finance charge would be assessed if payment of the outstading balance is not made. For rules governing the computation of foregone interest for demand loans with variable balances, see § 1.782–13(c).

(b) [Reserved for further definitions as needed]

§ 1.7872–11 Special rules.

(a) *Waiver, cancellation or forgiveness of interest payments.* If a loan is made requiring the payment of stated interest and the accrued but unpaid interest is subsequently waived, cancelled, or forgiven by the lender, such waiver, cancellation, or forgiveness is treated as if the interest had in fact been paid to the lender and then retransferred by the lender to the borrower but only if—

(1) The loan initially would have been subject to section 7872 had it been made without interest;

(2) The waiver, cancellation of forgiveness does not include in substantial part the loan principal; and

(3) A principal purpose of the waiver, cancellation, or forgiveness is to confer a benefit on the borrower, such as to pay compensation or make a gift, a capital contribution, a distribution of money uner section 301, or a similar payment to the borrower.

The retransferred amount is characterized for Federal tax purposes in accordance with the substance of the transaction. The requisite purpose described in paragraph (a)(iii) of this section is presumed in the case of loans between family members, corporations and shareholders, employers and employees, or an independent contractor and a person for whom such independent contractor provides services unless the taxpayer can show by clear and convincing evidence that the interest obligation was waived, cancelled, or forgiven for a legitimate business purpose of the lender who is acting in the capacity as a creditor seeking to maximize satisfaction of a claim, such as in the case of a borrower's insolvency.

(b) *Disposition of interest or obligation in loan.* [Reserved]

(c) *Husband and wife treated as 1 person.* Section 7872(f)(7) provides that a husband and wife shall be treated as 1 person. Accordingly, all loans to or from the husband will be combined with all loans to or from the wife for purposes of applying section 7872. All loans between a husband and a wife are disregarded for purposes of section 7872.

(d) *Withholding.* In the case of any loan (term or demand) subject to section 7872, no amount is required to be withheld under chapter 24, relating to the collection of income tax at the source on wages and back-up withholding, with respect to any amount treated as transferred or retransferred under section 7872 (a) or (b). Withholding is required where appropriate, however, for purposes of chapter 21, relating to the Federal Insurance Contributions Act, and chapter 22, relating to the Railroad Retirement Tax Act, on any amount of money treated as transferred and retransferred between the lender and borrower because of the application of section 7872.

(e) *Treatment of renegotiations.* [Reserved]

(f) *Loans denominated in foreign currencies*—(1) *Applicable rate.* If a loan is denominated in a currency other than the U.S. dollar, then for purposes of section 7872 and the regulations thereunder, a rate that constitutes a market interest rate in the currency in which the loan is denominated shall be substituted for the applicable Federal rate.

(2) *Treatment of imputed transfer as interest*—(i) *In general.* If a loan is denominated in a currency other than the U.S. dollar then, notwithstanding section 7872(a)(1)(B), § 1.7872–6, and § 1.7872–7, the amount of imputed interest treated as retransferred by the borrower to the lender shall only be treated as interest to the extent consistent with other principles of tax law regarding foreign currency lending transactions and to the extent provided in this paragraph (f)(2).

(ii) *Loans denominated in appreciating currencies.* [Reserved]

(iii) *Loans denominated in depreciating currencies.* [Reserved]

(3) *Example.* The provisions of this paragraph (f)(1) may be illustrated by the following example.

Example. A lends here daughter B the sum of 100,000 foreign currency units, repayable in 5 years with interest payable semiannually at a rate of 12 percent. Asaume that the market rate of interest for loans denominated in that foreign currency at the time of the transaction is 30 percent, compounded semiannually, and that the current exchange rate is 5 foreign currency units to the dollar. A has made a below-market gift loan to B. The amount of A's gift to B is the excess of 100,000 foreign currency units (or $20,000) over the present value of all payments to be made under the loan, using a discount rate of 30 percent, which is 54,831 foreign units (or $10,966). Thus, the amount of A's gift is $9,034.

(g) *Reporting requirements*—(1) *Lender.* A lender must attach a statement to the lender's income tax return for any taxable year in which the lender either has interest imputed under section 7872 or claims a deduction for an amount deemed to be transferred to a borrower under section 7872. The statement must—

(i) Explain that it relates to an amount includible in income or deductible by reason of section 7872,

(ii) Provide the name, address, and taxpayer identification number of each borrower,

(iii) Specify the amount of imputed interest income and the amount and character of any item deductible by reason of section 7872 attributable to each borrower,

(iv) Specify the mathematical assumptions used (*e.g.*, 360 day calendar year, the exact method or the approximate method for computing interest for a short period (see, § 1.7872–13)) for computing the amounts imputed under section 7872, and

(v) Include any other information required by the return or the instructions thereto.

(2) *Borrower.* A borrower must attach a statement to the borrower's income tax return for any taxable year in which the borrower either has income from an imputed transfer under section 7872 or claims a deduction for an amount of interest expense imputed under section 7872. The statement must—

(i) Explain that it relates to an amount includible in income or deductible by reason of section 7872,

(ii) Provide the name, address, and taxpayer identification number of each lender,

(iii) Specify the amount of imputed interest expense and the amount and character of any income imputed under section 7872 attributable to each lender,

(iv) Specify the mathematical assumptions used (*e.g.*, 360 day calendar year, the exact method or the approximate method for computing interest for a short period (see, § 1.7872–13)), for computing the amounts imputed under section 7872, and

(v) Include any other information required by the return or the instructions thereto.

(3) *Special rule for gift loans.* In the case of a gift loan directly between natural persons, the lender must recognize the entire amount of interest income imputed under section 7872 (determined without regard to section 7872(d)(1)) unless the borrower notifies the lender, in a signed statement, of the amount of the borrower's net investment income properly allocable to the loan according to the provisions of section 7872(d)(1) and § 1.7872–8(c)(6).

(4) *Information and reporting.* All amounts imputed under section 7872 (*e.g.*, interest, compensation, gift) are characterized in accordance with the substance of the transaction and, except as otherwise provided in the regulations under section 7872, are treated as so characterized for all purposes of the Code. Accordingly, all applicable information and reporting requirements (*e.g.*, reporting on Form W–2 and Form 1099) must be satisfied.

§ 1.7872–12 Computational rules to determine sufficient stated interest for short periods.

(a) *Scope.* This section provides computational rules only for the purpose of determining whether the interest payable on a loan during a short period is sufficient to prevent characterization of the loan as a below-market loan under § 1.7872–3. For rules for the calculation of the amount of interest to be imputed on a below-market loan, including rules for short periods, see § 1.7872–13 and § 1.7872–14.

(b) *Short period defined*—(1) *In general.* A short period (as referred to in § 1.7872–3(d)) for a loan is any period shorter than the regular compounding period or regular payment interval required under the loan agreement. Generally, a short period will arise at the beginning or the end of a loan (or at the time the loan first become subject to section 7872 because of the application of the *de minimis* provisions). For example, a loan made on January 17, 1985, and calling for semiannual payments of interest on June 30 and December 31 of each year will have a short period beginning on January 17, 1985, and ending on June 30, 1985.

(2) *Special short periods in the case of demand loans.* In the case of a demand loan, in addition to any short periods described in paragraph (b)(1) of this section, additional short periods may also arise because of the need to adjust the applicable Federal rate on January 1 and July 1 of each year. These short periods arise in cases when the dates January 1 or July 1 fall within the compounding periods or payment intervals required under the loan agreement. For example, a below market demand loan made on April 1, 1985, that is outstanding throughout 1985 and that calls for semiannual interest payments on September 30 and March 31 of each year will have 3 short periods in 1985. The first short period begins on April 1, 1985, and ends on June 30, 1985. The second short period begins on July 1, 1985, and ends on September 30, 1985. The third short period begins on October 1, 1985, and ends on December 31, 1985.

(c) *Interest payable for a short period*—(1) *Exact method.* The smallest amount of interest that must be paid for a short period in order to prevent the loan from being a below-market loan is determined by the exact method. The exact method assumes daily compounding interest.

(2) *Approximate method.* The approximate method is also provided for the convenience of taxpayers who do not wish to use the exact method. The approximate method assumes simple interest within any compounding period and will always produce an amount of interest for the short period that is slightly higher than that produced under the exact method. Under this method, a sufficient amount of interest for any short period is determined by multiplying the amount that would

constitute sufficient stated interest for a full period by a fraction the numerator of which is equal to the length of the short period and the denominator of which is the length of a full period.

(3) *Counting convention.* In computing the length of a short period, any reasonable convention may be used. Common conventions are "30 days per month/360 days per year", "actual days per month/actual days per year", and "actual days per month/360 days per year". The examples in the regulations under section 7872 all use the "30 days per month/360 days per year" convention.

(d) *Examples.* This section may be illustrated by the following examples.

Example (1). On February 1, 1986, A makes a $100,000 loan to B for a term of 4 months. The loan is repaid on May 31, 1986. Assume that the applicable Federal rate on February 1, 1986, for a loan of this term is 10 percent, compounded semiannually. Using the exact method, the amount of interest that must be paid on May 31, 1986, if the loan is not to be a below-market loan is $3,306.16, calculated as follows:

$100,000 × [(1 + .10/2)^4/6 − 1] = $3,306.16

Example (2). Assume the same facts as in Example (1). Using the approximate method, a sufficient amount of interest is stated on the loan if $3,333.33 of interest is payable on May 31, 1986, calculated as follows:

$100,000 × [(.10/2) × (4/6)] = $3,333.33

§ 1.7872–13 Computation of foregone interest.

(a) *Demand loans outstanding for an entire calendar year*—(1) *In general.* In the case of a below-market demand loan of a fixed principal amount that remains outstanding for an entire calendar year, the amount of foregone interest (as referred to in § 1.7872–6(c)) shall be the excess of

(i) The result produced when the "blended annual rate" is miltiplied by the principal amount of the loan, over

(ii) The sum of all amounts payable as interest on the loan properly allocable to the calendar year (including all amounts of original issue discount allocated to that year under section 1272).

The "blended annual rate" will be published annually by the Commissioner and is determined generally by blending the applicable Federal rates for demand loans outstanding for the entire year.

(2) *Example.* Paragraph (a)(1) may be illustrated by the following example.

Example. On January 1, 1985, A makes a $100,000 demand loan to B with stated interest equal to 9 percent. Interest is payable semiannually on June 30, and December 31. The loan remains outstanding for the entire year. On both June 30, and December 31, 1985, B makes a $4,500 payment of interest to A. Assume that the blended annual rate for 1985 is 10.45 percent. The amount of foregone interest is $1,450, computed as follows:

$10,450 = $100,000 × 10.45 percent

$1,450 = $10,450 − $9,000

(b) *Demand loans outstanding for less than an entire calendar year*—(1) *In general.* In the case of any below-market demand loan outstanding for less than the calendar year, the amount of foregone interest shall be the excess of—

(i) The amount of interest ("I") which would have been payable on the loan for the year if interest accrued on the loan at the applicable Federal rate and were payable on the date specified in section 7872(a)(2) and § 1.7872–6(b), over

(ii) The sum of all amounts payable as interest on the loan properly allocable to the calendar year (including all amounts of original issue discount allocated to that year under section 1272).

In general, "I" is determined by assuming daily compounding of interest. However, individual taxpayers who are parties to below-market loans in the aggregate of $250,000 or less may choose (see § 1.7872–11(g)) to compute and report foregone interest under the approximate method set forth in paragraph (b)(2) of this section. If the taxpayer chooses the approximate method but fails to properly compute the amount of foregone interest under that method, the correct amount of foregone interest will be recomputed under the approximate method.

(2) *Approximate method.* Under the approximate method, "I" is calculated as follows:

(i) *Loan outstanding during one semiannual period only.* If a loan is outstanding only during one semiannual period of a calendar year, to determine "I", multiply the principal amount of the loan by one-half the applicable Federal rate based on semiannual compounding in effect for that loan, then multiply the result by a fraction representing the portion of the semiannual period during which the loan was outstanding.

(ii) *Example.* Paragraph (b)(2)(i) of this section may be illustrated by the following example.

Example. A $200,000 interest-free demand loan is outstanding on January 1, 1986, and is repaid on March 31, 1986. Assume that the applicable Federal rate (based on semiannual compounding) for demand loans made in January 1986, is 10 percent. The amount of interest that would have been payable on the loan for the year if the loan provided for interest at the applicable Federal rate determined under the approximate method is $5,000, computed as follows:

$5,000 = $200,000 × (.10/2) × (3/6)

Because no interest is payable on the loan, this amount is also the amount of foregone interest.

(iii) *Loans outstanding during both semiannual periods.* If a loan is outstanding for at least part of each semiannual period (but less than the full calendar year), then, under the approximate method, "I" must be calculated in two steps. First, calculate an amount of interest for the first semiannual period by treating the loan as if it were repaid on June 30, using the approach described in paragraph (b)(3)(i) of this section. Second, add this amount of interest to the principal of the loan, and then calculate an amount of interest for the second semiannual period as if the loan of this higher amount were made on July 1, again using the approach described in paragraph (b)(3)(i) of this section. The sum of these two interest amounts is the value for "I" calculated under the approximate method.

(3) *Examples.* Paragraph (b)(2) of this section may be illustrated by the following examples.

Example (1). On March 1, 1986, A makes a $100,000 interest-free demand loan to B. The loan remains outstanding on December 31, 1986. Assume that the applicable Federal rate for a demand loan made in March 1986, based on semiannual compounding, for the first semiannual period in 1986 is 9.89 percent and that the applicable Federal rate, based on semiannual compounding, for a demand loan outstanding in July 1986 is 10.50 percent. The amount of foregone interest under the exact method is $8,691.76, calculated as follows:

$100,000 × [(1 + .0989/2)^4/6 (1 + .1050/2) − 1] = $8,691.76

Example (2). (i) Assume the same facts as in Example (1). The amount of foregone interest under the approximate method is $8,719.92, calculated as follows:

(ii) For the short period March 1 to June 30, 1986, the amount of foregone interest is $3,296.67, calculated as follows:

$3,296.67 = $100,000 × (.0989/2) × (4/6)

(iii) For the second semiannual period in 1986, the amount of foregone interest is computed by first adding the interest for the first semiannual period ($3,296.67) to the original principal amount to obtain a new principal amount of $103,296.67. Foregone interest for the second semiannual period is then $5,423.08, computed as follows:

$5,423.08 = $103,296.67 × (.1050/2)

(iv) Using the approximate method, the amount of foregone interest for 1986 is $8,719.75 ($3,296.67 + $5,423.08).

(c) *Demand loans with fluctuating loan balances.* If a demand loan does not have a constant outstanding principal amount during a period, the amount of foregone interest shall be computed according to the principles set forth in paragraph (b) of this section, with each increase in the outstanding loan balance being treated as a new

loan and each decrease being treated as first a repayment of accrued but unpaid interest (if any), and then a repayment of principal.

(d) *Examples.* This provision of paragraph (c) of this section may be illustrated by the following examples.

Example (1). (i) On October 1, 1984, C makes a $50,000 interest-free demand loan to D. On October 1, 1985, C makes an additional interest-free demand loan of $25,000 to D. Assume that section 7872 applies to both loans, that the blended annual rate for 1985 is 10.45 percent, and that the applicable Federal rate based on semiannual compounding for demand loans made in October 1985, is 10.50 percent. The amount of foregone interest for 1985 is calculated as follows:

(ii) $50,000 is outstanding for the entire year. The foregone interest on this amount is [$5,000 × .1045] = $5,225.00

(iii) $25,000 is outstanding for the last three months of 1985. Under the exact method, the amount of foregone interest on this portion of the loan is $647.86, computed as follows:

$25,000 × [(1 + .1050/2)$^{3/6}$ − 1] = $647.86

Under the approximate method, the amount of foregone interest is $656.25, computed as follows:

$25,000 × (.1050/2) × (3/6) = $656.25

(iv) The total amount of foregone interest is $5,872.86 ($5,225.00 + $647.86) under the exact method, and $5,881.25 ($5,225.00 + $656.25) under the approximate method.

Example (2). (i) On September 1, 1985, E makes a $100,000 interest-free demand loan to F. The loan agreement requires F to repay $10,000 of the principal amount of the loan at the end of each month that the loan is outstanding. Assume that section 7872 applies to the loan and that the applicable Federal rate based on semiannual compounding for demand loans made in September 1985, is 10.50 percent. The amount of foregone interest for 1985 is calculated as follows:

(ii) $70,000 is outstanding for four months. Under the exact method, the amount of foregone interest on this portion of the loan is $2,429.05, computed as follows:

$70,000 × [(1 + .1050/2)$^{4/6}$ − 1] = $2,429.05

Under the approximate method, the amount of foregone interest on this portion of the loan is $2,450.00, computed as follows:

$70,000 × (.1050/2) × (4/6) = $2,450.00

(iii) $10,000 is outstanding for 3 months. Under the exact method, the amount of foregone interest on this portion of the loan is $259.14, computed as follows:

$10,000 × [(1 + .1050/2)$^{3/6}$ − 1] = $259.14

Under the approximate method, the amount of foregone interest on this portion of the loan is $262.50, computed as follows:

$10,000 × (.1050/2) × (3/6) = $262.50

(iv) An additional $10,000 is outstanding 2 months. Under the exact method, the amount of foregone interest on this portion of the loan is $172.02, computed as follows:

$10,000 × [(1 + .1050/2)$^{2/6}$ − 1] = $172.02

Under the approximate method, the amount of foregone interest on this portion of the loan is $175.00, computed as follows:

$10,000 × (.1050/2 × (2/6) = $175.00

(v) A final $10,000 is outstanding for 1 month. Under the exact method, the amount of foregone interest on this portion of the loan is $85.65, computed as follows:

$10,000 × [(1 + .1050/2)$^{1/6}$ − 1] = $85.65

Under the approximate method, the amount of foregone interest on this portion of the loan is $87.50, computed as follows:

$10,000 × (.1050/2) × (1/6) = $87.50

(vi) The total amount of foregone interest is $2,945.66 under the exact method, and $2,975.00 under the approximate method.

(e) *Gift term loans and certain loans conditioned on future service*—(1) *In general.* In the case of any gift term loan or any term loan that is treated as a demand loan as provided in § 1.7872–10(a)(5), the amount of foregone interest for income tax purposes shall be computed as if the loan were a demand loan, except that:

(i) In applying paragraph (a)(1)(i) of this section, use the applicable Federal rate based on annual compounding in effect on the day the loan is made instead of the blended annual rate, and

(ii) In applying paragraph (b) of this section, use the applicable Federal rate based on semiannual compounding in effect on the day the load is made instead of the applicable Federal rate for demand loans in effect during the period for which foregone interest is being computed.

(2) *Example.* The provisions of this paragraph (e) may be illustrated by the following examples:

Example (1). On January 1, 1986, parent P makes a $200,000 gift term loan to child C. The loan agreement provides that the term of the loan is four years and that 5 percent simple interest is payable annually. Both P and C are calendar year taxpayers, and both are still living on December 31, 1986. Assume that the Federal mid-term rate based on annual compounding in effect on January 1, 1986, is 11.83 percent. The loan is a below-market loan. The amount of foregone interest for each year is $13,600.00, computed as follows:

($200,000) × .1183 = $23,660.00

$23,660.00 − $10,000.00 = $13,660.00

For gift tax purposes, an imputed gift is treated as made on January 1, 1986, and is equal to the excess of the amount loaned ($200,000) over the present value of all payments due under the loan, discounted at 11.83 percent compounded annually ($153,360.82), or $41,639.82. For rules for determining the computation of present value, see § 1.7872–14.

Example (2). Assume the same facts as in Example (1) except that C repays the loan on September 30, 1987, along with an interest payment of $7,500. For income tax purposes, the imputed payments are treated as transferred on December 31, 1986 and September 30, 1987. The amount of the imputed payments for 1986 are the same as in Example (1). For 1987, under the exact method the amount of foregone interest is $9,994.73, computed as follows:

$17,494.73 = $200,000 × [(1 + .1183)$^{9/12}$ − 1]

$17,494.73 − $7,500 = $9,994.73

For gift tax purposes, the imputed gift is treated as made January 1, 1986, and is the same as in Example (1).

(f) *Allocation of stated interest.* If interest that is payable on a demand loan is properly allocable to a period which includes more than one calendar year, the amount of interest to be allocated to each calendar year is determined by using any reasonable method of allocation.

(g) *Counting conventions*—(1) *Whole periods.* All whole periods, whether expressed annually, semiannually, quarterly, or monthly, shall be treated as having equal length. For example, a leap year shall be treated as having the same number of days as a non-leap year; all months shall be treated as having the same number of days.

(2) *Short periods.* in computing the length of a short period, any reasonable convention may be used. See § 1.7872–12(c)(2) for a list of conventions commonly used.

§ 1.7872–14 Determination of present value.

(a) *In general.* This section provides rules for computing the present value of a payment (as referred to in § 1.7872–7(a)(1)) to be made in the future. In general, for purposes of section 7872, the present value of a loan payment to be made in the future is the amount of that payment discounted at the applicable Federal rate from the date in the future that the payment is due to the date on which the computation is made. For this purpose, the computation date is the date the loan first becomes subject to section 7872. To determine the present value of a payment, use the applicable Federal rate in effect on the day the loan is made the reflects the compounding assumption (*i.e.*, annual, semiannual, quarterly, or monthly) that is appropriate for the loan. See § 1.7872–3(b).

(b) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). (i) On July 1, 1984, corporation A makes a $200,000 interest-free three-year term loan to shareholder B. The applicable Federal rate is 10-percent, compounded semiannually.

(ii) The present value of this payment is $149,243.08, determined as follows:

$$\$149{,}243.08 = \frac{\$200{,}000}{[1 + (.10/2)]^{6}}$$

(iii) The excess of the amount loaned over the present value of all payments on the loan ($200,000 − $149,243.08), or $50,756.92, is

treated as a distribution of property (characterized according to section 301) paid to B on July 1, 1984. The same amount, $50,756.92, is treated as original issue discount under sections 1272 and 163(e).

Example (2). (i) On July 1, 1984, Employer E makes a $3,000 interest-free three year compensation-related term loan to employee W. On December 1, 1984, E makes an $9,000 interest-free compensation-related demand loan to W. The demand loan remains outstanding throughout December 1984. The two loans are the only loans outstanding between E and W during 1984, and neither is characterized under section 7872(c)(1)(D) as a tax avoidance loan. The applicable Federal rate for all loans for periods before January 1, 1985, is 10 percent, compounded semiannually.

(ii) For the period beginning on July 1, 1984, and ending on November 30, 1984, the provisions of section 7872 do not apply to the $3,000 loan because of the application of the *de minimis* rules of section 7872(c)(3).

(iii) On December 1, 1984, however, the aggregate amount of loans outstanding between E and W exceeds $10,000. As a result, section 7872 applies to both loans for December 1984. Both the imputed transfer and the imputed interest payment with respect to the $9,000 demand loan are determined under section 7872(a). The amount of the imputed transfer by E to W with respect to the $3,000 term loan is determined under section 7872(b)(1). An amount equal to the amount of the imputed transfer with respect to the $3,000 term loan is treated as original issue discount.

(iv) With respect to the $3,000 term loan, the amount of the imputed transfer is equal to the excess of the amount loaned, over the present value of all payments which are required to be made under the $3,000 two-year term loan agreement, determined as of December 1, 1984 (the day section 7872 first applies to the $3,000 loan). The present value of $3,000 payable on June 30, 1987, determined as of December 1, 1984, is $2,331.54, computed as follows:

$$\$2,331.54 = \frac{\$3,000}{(1+.10/2)^{5\frac{1}{6}}}$$

The imputed transfer on the $3,000 loan is $668.46 ($3,000.00 − $2,331.54).

(v) The foregone interest on the $9,000 demand loan is determined as of December 31, 1984, with respect to the one month during 1984 to which section 7872 applies to the loan. The amount of foregone interest for 1984 under the exact method is $73.48, computed as follows:

$$\$73.48 = \$9,000 \times [(1+.10/2)^{1/6} - 1]$$

Example (3). (i) Assume the same facts as in Example (2) except that the provisions of the $3,000 three-year term loan require W to make annual payments of interest at a 5 percent simple rate and except that E makes W the $9,000 loan on November 27, 1985.

(ii) Under the agreement W pays $150 (5 percent of $3,000) on June 30, 1985, June 30, 1986, and June 30, 1987. Since the first of these payments is payable prior to November 27, 1985, only the second and third $150 payments are taken into account. W is treated as paying $150 on June 30, 1986 and $3,150 ($3,000 principal and $150 interest) on June 30, 1987.

(iii) The present value as of November 27 1984 of the $150 payable on June 30, 1986, is $128.39, computed as follows:

$$\$128.39 = \frac{\$150.00}{(1+.10/2)^{3\frac{34}{180}}}$$

(iv) The present value as of November 27, 1984 of the $3,150 payable on June 30, 1987, is $2,445.47, computed as follows:

$$\$2,445.47 = \frac{\$3,150.00}{(1+.10/2)^{5\frac{34}{180}}}$$

The sum of these two present values of $2,573.86 ($128.39 + $2,445.47). Therefore, the amount of the imputed transfer with respect to the $3,000 loan is $426.14 ($3,000.00 − $2,573.86).

(v) The foregone interest on the $9,000 demand loan under the exact method is $83.33 ($9,000 × [(1+.10/2)$^{34/180}$ − 1]).

Gift Tax Regulations

PART 25—[AMENDED]

Par. 3. The authority for Part 25 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * § 25.2512–4 and 25.7872–1 also issued under 26 U.S.C. 7872.

Par. 4. Section 25.2512–4 is amended by adding a new sentence at the end to read as follows:

§ 25.2512–4 Valuation of notes.

* * * See § 25.7872–1 for special rules in the case of gift loans (within the meaning of § 1.7872–4(b)) made after June 6, 1984.

Par. 5. New § 25.7872–1 is added in the appropriate place to read as follows:

§ 25.7872–1 Certain below-market loans.

For purposes of chapter 12 of the Internal Revenue Code, relating to gift tax, if a taxpayer makes a gift loan (within the meaning of § 1.7872–4(b)) that is a term loan (within the meaning of § 1.7872–10(a)(2)) and that is made after June 6, 1984, the excess of the amount loaned over the present value of all payments which are required to be made under the terms of the loan agreement shall be treated as a gift from the lender to the borrower on the date the loan is made. If a taxpayer makes a gift loan that is a demand loan (within the meaning of § 1.7872–10(a)(1)) and that is outstanding during any calendar period after June 6, 1984, and not repaid before September 17, 1984, the amount of foregone interest (within the meaning of section 7872(e)(2)) attributable to that calendar period shall be treated as a gift from the lender to the borrower. The *de minimis* exception described in section 7872(c)(2) applies to the gift tax treatment of a gift loan. In the case of a term gift loan, however, once section 7872 applies to the loan, the *de minimis* exception will not apply to the loan at some later date regardless of whether the aggregate outstanding amount of loans does not continue to exceed the limitation amount. For a detailed analysis of section 7872, see the income tax regulations under section 7872, § 1.7872–1 through § 1.7872–14.

Estate Tax Regulations

PART 20—[AMENDED]

Par. 6. The authority for Part 20 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * § 20.2031–4 and 20.7872–1 also issued under 26 U.S.C. 7872.

Par. 7. Section 20.2031–4 is amended by adding a new sentence at the end to read as follows:

§ 20.2031–4 Valuation of notes.

* * * See § 20.7872–1 for special rules in the case of gift loans (within the meaning of § 1.7872–4(b)) made after June 6, 1984.

Par. 8. New § 20.7872–1 is added in the appropriate place to read as follows:

§ 20.7872–1 Certain below-market loans.

For purposes of chapter 11 of the Internal Revenue Code, relating to estate tax, a gift term loan (within the meaning of § 1.7872–4(b)) that is made after June 6, 1984, shall be valued at the lesser of:

(i) The unpaid stated principal, plus accrued interest; or

(ii) The sum of the present value of all payments due under the note (including accrual interest), using the applicable Federal rate for loans of a term equal to the remaining term of the loan in effect at the date of death.

No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectibility of the loan have changed significantly since the time the loan was made. This section applies with respect to any term loan made with donative intent after June 6, 1984, regardless of the interest rate under the loan agreement, and regardless of whether that interest rate exceeds the applicable Federal rate in effect on the day on which the loan was made.

Foundation and Similar Excise Taxes

PART 53—[AMENDED]

Par. 9. The authority for Part 53 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * § 53.4941(d)-2 also issued under 26 U.S.C. 7872.

Par. 10. Section 53.4941(d)-2 is amended by revising paragraph (c)(2) to read as follows:

§ 53.4941(d)-2 Specific acts of self-dealing.

* * * * *

(c) *Loans.* * * *

(2) *Loans without interest.* Subparagraph (1) of this paragraph shall not apply to the lending of money or other extension of credit by a disqualified person to a private foundation if the loan or other extension of credit is without interest (determined without regard to foregone interest described in section 7872) or other charge.

PART 602—[AMENDED]

OMB Control Numbers Under the Paperwork Reduction Act

Par. 11. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 12. Section 602.101(c) is amended by adding in the appropriate locations, "§ 1.7872-11 * * * 1545- ."

* * * * *

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

[FR Doc. 85-19785 Filed 8-15-85; 12:11 pm]

BILLING CODE 4830-01-M

DEPARTMENT OF LABOR

Mine Safety and Health Administration

30 CFR Parts 56 and 57

Metal and Nonmetal Mines; Public Hearings

AGENCY: Mine Safety and Health Administration, Labor.

ACTION: Notice of Extension of Public Hearings.

SUMMARY: The Mine Safety and Health Administration (MSHA) will hold a supplemental public hearing on its proposal to revise the existing safety standards for loading, hauling, and dumping at metal and nonmetal mines.

DATE: The public hearing will be held on August 27, 1985, beginning at 9:00 a.m.

ADDRESS: The public hearing will be held in Room 622A, 4015 Wilson Boulevard, Arlington, Virginia 22203.

FOR FURTHER INFORMATION CONTACT: Patricia W. Silvey, Director, Office of Standards, Regulations and Variances, MSHA, phone (703) 235-1910.

SUPPLEMENTARY INFORMATION: The purpose of the supplemental hearing is to provide interested persons with a further opportunity to comment on the proposed standard dealing with brakes on self-propelled equipment (56/57.9202) and to review video tapes made by MSHA during its field tests to evaluate vehicle braking performance.

MSHA held public hearings on its proposal to revise the loading, hauling, and dumping standards on August 5 in Minneapolis, Minnesota; August 7 in Phoenix, Arizona; and August 9 in Birmingham, Alabama (50 FR 27568, July 3, 1985). During each hearing a video tape was presented to demonstrate to the public how brake testing would be conducted in the field. However, some commenters understood that MSHA would have more extensive video tapes from the various test sites available for viewing. These commenters requested that an opportunity be provided to view and discuss specific tapes in their original context. For this reason, MSHA will make all of the brake test video tapes available for review and comment at the supplemental hearing on August 27, 1985.

As announced during the Birmingham public hearing, the record and opportunity for comment on the proposed rule to revise the loading, hauling, and dumping standards has been extended from August 23, 1985 to September 6, 1985.

Dated August 16, 1985.

David A. Zegeer,

Assistant Secretary for Mine Safety and Health.

[FR Doc. 85-19981 Filed 8-19-85; 8:45 am]

BILLING CODE 4510-43-M

DEPARTMENT OF THE INTERIOR

National Park Service

36 CFR Part 50

National Capital Parks Regulations; Lafayette Park; Structure Prohibitions; Sign Limitations

AGENCY: National Parks Service, Interior.

ACTION: Proposed rule.

SUMMARY: This proposed rule amends the National Capital Parks regulations in § 50.19 of 36 Code of Federal Regulations to prohibit structures, with certain exceptions, and to place reasonable limitations on the size and number of signs placed or set down in Lafayette Park. The National Park Service has received numerous complaints from the general public concerning the presence in Lafayette Park of semi-permanent, billboard-type signs and large structures that interfere with the view of the White House, occupy an extensive amount of space and generally conflict with the historic and natural of the Park. Furthermore, concerns have been raised about damage to the Park and public safety. The proposed rule addresses the uses of Lafayette Park through a balancing of First Amendment freedoms of speech and expression against the rights of the park visitor to utilize this historic Park for traditional recreational and aesthetic purposes.

DATE: Written comments, suggestions, or objections regarding the proposed rule will be accepted until October 21, 1985.

ADDRESS: Written comments should be sent to Regional Director, National Capital Region, National Park Service, 1100 Ohio Drive, SW., Washington, D.C. 20242.

FOR FURTHER INFORMATION CONTACT: Sandra Alley, Associate Regional Director, Public Affairs, National Capital Region, National Park Service, 1100 Ohio Drive, SW., Washington, D.C. 20242, telephone (202) 426-6700; Richard G. Robbins, Assistant Solicitor, National Capital Parks, Office of the Solicitor, Department of the Interior, Washington, D.C. 20240, telephone (202) 343-4338.

SUPPLEMENTARY INFORMATION:

Background

1. History of Lafayette Park

Lafayette Park, originally know as the President's Park, is a rectangular area of approximately seven acres of land situated directly north of the White House on Pennsylvania Avenue. It is bounded on the east by Madison Place, north by H Street, and west by Jackson Place. The property was one of the first parcels of land donated by the original patentees to the Disttict Commissioners for the formation of the Federal City (later, Washington) in 1971. The site of what is now Lafayette Park (Park) was originally included in the area known as the President's House and the President's Park, according to the plans of Major Pierre L'Enfant. The entire area extended from 15th to 17th Streets, NW., and from H Street on the north and to the Potomac River on the south. In the early 1800's, President Thomas Jefferson