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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9179]

RIN 1545-BB62

Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains amendments to regulations relating to the capitalization of interest expense incurred in sale and leaseback transactions under the Economic Recovery Tax Act of 1981 (ERTA) safe harbor leasing provisions. The regulations affect taxpayers that provide purchase money obligations in connection with these transactions.

DATES: Effective Date: These regulations are effective February 23, 2005.

Applicability Dates: For dates of applicability, see §1.263A-15(a)(3).

FOR FURTHER INFORMATION CONTACT: Christian Wood, 202-622-4930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to 26 CFR Part 1. On May 20, 2004, the IRS

and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG-148399-02; 69 FR 29113) by cross reference to temporary regulations (TD 9129; 69 FR 29066) under section 263A(f) of the Internal Revenue Code (Code). These amendments pertain to the treatment of certain interest expense incurred by the lessor in a sale and leaseback transaction under the ERTA safe harbor leasing provisions (former section 168(f)(8), as enacted by section 201(a) of ERTA, Public Law 97-34, 95 Stat. 214). No comments in response to the proposed regulations or requests to speak at a public hearing were received, and no hearing was held. The proposed regulations under section 263A(f) are adopted by this Treasury decision.

#### **Effective Date**

These final regulations generally apply to interest incurred in taxable years beginning on or after May 20, 2004. In the case of property that is inventory in the hands of the taxpayer, these regulations apply to taxable years beginning on or after May 20, 2004. Taxpayers may elect to apply these regulations to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995 (the general effective date of the interest capitalization regulations).

In addition, for purposes of §1.263A-15(a)(2), the exclusion of purchase money obligations given by the lessor to the lessee (or a party related to the lessee) in a sale and leaseback transaction under former section 168(f)(8) as enacted by ERTA will be considered to be a reasonable position for the application of section 263A(f) in taxable

years beginning before January 1, 1995. Consequently, a taxpayer changing a method of accounting for property that is not inventory in the hands of the taxpayer to conform to these regulations may elect to include interest incurred after December 31, 1986, in taxable years beginning on or after December 31, 1986 (the general effective date of section 263A), and before January 1, 1995, in the determination of its adjustment under section 481(a). A taxpayer changing a method of accounting for property that is inventory in the hands of the taxpayer to conform to these regulations must compute a section 481(a) adjustment and revalue its beginning inventory in the year of change as if the new method of accounting had been in effect during all prior years.

### **Special Analyses**

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Drafting Information**

The principal authors of these regulations are Christian Wood and Grant Anderson

of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

#### **PART 1 -- INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §1.263A-9, paragraph (a)(4)(ix) is added to read as follows:

#### **§1.263A-9 The avoided cost method.**

(a) \* \* \*

(4) \* \* \*

(ix) A purchase money obligation given by the lessor to the lessee (or a party that is related to the lessee) in a sale and leaseback transaction involving an agreement qualifying as a lease under §5c.168(f)(8)-1 through §5c.168(f)(8)-11 of this chapter. See §5c.168(f)(8)-1(e) Example (2) of this chapter.

\* \* \* \* \*

#### **§1.263A-9T [Removed]**

Par. 3. Section 1.263A-9T is removed.

Par. 4. In §1.263A-15, paragraph (a)(3) is added to read as follows:

#### **§1.263A-15 Effective dates, transitional rules, and anti-abuse rule.**

(a) \* \* \*

(3) Section 1.263A-9(a)(4)(ix) generally applies to interest incurred in taxable years beginning on or after May 20, 2004. In the case of property that is inventory in the hands of the taxpayer, §1.263A-9(a)(4)(ix) applies to taxable years beginning on or after May 20, 2004. Taxpayers may elect to apply §1.263A-9(a)(4)(ix) to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995. A change in a taxpayer's treatment of interest to a method consistent with §1.263A-9(a)(4)(ix) is a change in method of accounting to which sections 446 and 481 apply.

\* \* \* \* \*

**§1.263A-15T [Removed]**

Par. 5. Section 1.263A-15T is removed.

Mark E. Matthews

Deputy Commissioner for Services and Enforcement.

Approved: February 15, 2005

Eric Solomon

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).