

available to debt instruments generally) with due consideration given to the maturities of the obligations.

(e) *Examples.* The following examples illustrate the rules of this section.

*Example 1.* Variable rate debt instrument that limits the amount of increase and decrease in the rate—(i) *Facts.* On July 1, 1996, A sells nonpublicly traded property to B in return for a 5-year debt instrument that provides for interest to be paid on July 1 of each year, beginning on July 1, 1997, based on the prime rate of a local bank on that date. However, the interest rate cannot increase or decrease from one year to the next by more than .25 percentage points (25 basis points).

(ii) *Significant restriction.* The debt instrument is a variable rate debt instrument (as defined in § 1.1275-5) that provides for stated interest at a qualified floating rate. Assume that based on all the facts and circumstances, the restriction is a significant restriction on the variations in the rate of interest. Under paragraph (c)(2)(ii) of this section, the applicable Federal rate is determined by reference to the term of the debt instrument, and the applicable Federal rate is the Federal mid-term rate.

*Example 2. Installment obligation—(i) Facts.* On January 1, 1996, A sells nonpublicly traded property to B in exchange for a debt instrument that calls for a payment of \$500,000 on January 1, 2001, and a payment of \$1,000,000 on January 1, 2006. The debt instrument does not provide for any stated interest.

(ii) *Determination of term.* The debt instrument is an installment obligation. Under paragraph (c)(1) of this section, the term of the debt instrument is its weighted average maturity (as defined in § 1.1273-1(e)(3)). The debt instrument's weighted average maturity is 8.33 years, which is the sum of (A) the ratio of the first payment to total payments (500,000/1,500,000), multiplied by the number of complete years from the issue date until the payment is due (5 years), and (B) the ratio of the second payment to total payments (1,000,000/1,500,000), multiplied by the number of complete years from the issue date until the second payment is due (10 years).

(iii) *Applicable Federal rate.* Based on the calculation in paragraph (ii) of this example, the term of the debt instrument is treated as 8.33 years. Consequently, the applicable Federal rate is the Federal mid-term rate.

[T.D. 8517, 59 FR 4823, Feb. 2, 1994]

#### § 1.1274-5 Assumptions.

(a) *In general.* Section 1274 does not apply to a debt instrument if the debt instrument is assumed, or property is taken subject to the debt instrument,

in connection with a sale or exchange of property, unless the terms of the debt instrument, as part of the sale or exchange, are modified in a manner that would constitute an exchange under section 1001.

(b) *Modifications of debt instruments—*(1) *In general.* Except as provided in paragraph (b)(2) of this section, if a debt instrument is assumed, or property is taken subject to a debt instrument, in connection with a sale or exchange of property, the terms of the debt instrument are modified as part of the sale or exchange, and the modification triggers an exchange under section 1001, the modification is treated as a separate transaction taking place immediately before the sale or exchange and is attributed to the seller of the property. For purposes of this paragraph (b), a debt instrument is not considered to be modified as part of the sale or exchange unless the seller knew or had reason to know about the modification.

(2) *Election to treat buyer as modifying the debt instrument—(i) In general.* Rather than having the rules in paragraph (b)(1) of this section apply, the seller and buyer may jointly elect to treat the transaction as one in which the buyer first assumed the original (unmodified) debt instrument and then subsequently modified the debt instrument. For this purpose, the modification is treated as a separate transaction taking place immediately after the sale or exchange.

(ii) *Time and manner of making the election.* The buyer and seller make the election under paragraph (b)(2)(i) of this section by jointly signing a statement that includes the names, addresses, and taxpayer identification numbers of the seller and buyer, and a clear indication that the election is being made under paragraph (b)(2)(i) of this section. Both the buyer and the seller must sign this statement not later than the earlier of the last day (including extensions) for filing the Federal income tax return of the buyer or seller for the taxable year in which the sale or exchange of the property occurs. The buyer and seller should attach this signed statement (or a copy thereof) to their timely filed Federal income tax returns.

(c) *Wraparound indebtedness.* For purposes of paragraph (a) of this section, the issuance of wraparound indebtedness is not considered an assumption.

(d) *Consideration attributable to assumed debt.* If, as part of the consideration for the sale or exchange of property, the buyer assumes, or takes the property subject to, an indebtedness that was issued with OID (including a debt instrument issued in a prior sale or exchange to which section 1274 applied), the portion of the buyer's basis in the property and the seller's amount realized attributable to the debt instrument equals the adjusted issue price of the debt instrument as of the date of the sale or exchange.

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**§ 1.1274A-1 Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.**

(a) *In general.* Section 1274A allows the use of a lower test rate for purposes of sections 483 and 1274 in the case of a qualified debt instrument (as defined in section 1274A(b)) and, if elected by the borrower and the lender, the use of the cash receipts and disbursements method of accounting for interest on a cash method debt instrument (as defined in section 1274A(c)(2)). This section provides special rules for qualified debt instruments and cash method debt instruments.

(b) *Rules for both qualified and cash method debt instruments—(1) Sale-leaseback transactions.* A debt instrument issued in a sale-leaseback transaction (within the meaning of section 1274(e)) cannot be either a qualified debt instrument or a cash method debt instrument.

(2) *Debt instruments calling for contingent payments.* A debt instrument that provides for contingent payments cannot be a qualified debt instrument unless it can be determined at the time of the sale or exchange that the maximum stated principal amount due under the debt instrument cannot exceed the amount specified in section 1274A(b). Similarly, a debt instrument that provides for contingent payments cannot be a cash method debt instrument unless it can be determined at the time of the sale or exchange that the maximum stated principal amount

due under the debt instrument cannot exceed the amount specified in section 1274A(c)(2)(A).

(3) *Aggregation of transactions—(i) General rule.* The aggregation rules of section 1274A(d)(1) are applied using a facts and circumstances test.

(ii) *Examples.* The following examples illustrate the application of section 1274A(d)(1) and paragraph (b)(3)(i) of this section.

*Example 1. Aggregation of two sales to a single person.* In two transactions evidenced by separate sales agreements, A sells undivided half interests in Blackacre to B. The sales are pursuant to a plan for the sale of a 100 percent interest in Blackacre to B. These sales or exchanges are part of a series of related transactions and, thus, are treated as a single sale for purposes of section 1274A.

*Example 2. Aggregation of two purchases by unrelated individuals.* Pursuant to a plan, unrelated individuals X and Y purchase undivided half interests in Blackacre from A and subsequently contribute these interests to a partnership in exchange for equal interests in the partnership. These purchases are treated as part of the same transaction and, thus, are treated as a single sale for purposes of section 1274A.

*Example 3. Aggregation of sales made pursuant to a tender offer.* Fifteen unrelated individuals own all of the stock of X Corporation. Y Corporation makes a tender offer to these 15 shareholders. The terms offered to each shareholder are identical. Shareholders holding a majority of the shares of X Corporation elect to tender their shares pursuant to Y Corporation's offer. These sales are part of the same transaction and, thus, are treated as a single sale for purposes of section 1274A.

*Example 4. No aggregation for separate sales of similar property to unrelated persons.* Pursuant to a newspaper advertisement, X Corporation offers for sale similar condominiums in a single building. The prices of the units vary due to a variety of factors, but the financing terms offered by X Corporation to all buyers are identical. The units are purchased by unrelated buyers who decided whether to purchase units in the building at the price and on the terms offered by X Corporation, without regard to the actions of other buyers. Because each buyer acts individually, the sales are not part of the same transaction or a series of related transactions and, thus, are treated as separate sales.

(4) *Inflation adjustment of dollar amounts.* Under section 1274A(d)(2), the dollar amounts specified in sections 1274A(b) and 1274A(c)(2)(A) are adjusted