

(c) *Effective date.* This section applies to sales and exchanges that occur on or after April 4, 1994. Taxpayers, however, may rely on this section for sales and exchanges that occur after December 21, 1992, and before April 4, 1994.

[T.D. 8517, 59 FR 4807, Feb. 2, 1994]

#### § 1.483-4 Contingent payments.

(a) *In general.* This section applies to a contract for the sale or exchange of property (the overall contract) if the contract provides for one or more contingent payments and the contract is subject to section 483. This section applies even if the contract provides for adequate stated interest under § 1.483-2. If this section applies to a contract, interest under the contract is generally computed and accounted for using rules similar to those that would apply if the contract were a debt instrument subject to § 1.1275-4(c). Consequently, all noncontingent payments under the overall contract are treated as if made under a separate contract, and interest accruals on this separate contract are computed under rules similar to those contained in § 1.1275-4(c)(3). Each contingent payment under the overall contract is characterized as principal and interest under rules similar to those contained in § 1.1275-4(c)(4). However, any interest, or amount treated as interest, on a contract subject to this section is taken into account by a taxpayer under the taxpayer's regular method of accounting (e.g., an accrual method or the cash receipts and disbursements method).

(b) *Examples.* The following examples illustrate the provisions of paragraph (a) of this section:

*Example 1. Deferred payment sale with contingent interest—(i) Facts.* On December 31, 1996, A sells depreciable personal property to B. As consideration for the sale, B issues to A a debt instrument with a maturity date of December 31, 2001. The debt instrument provides for a principal payment of \$200,000 on the maturity date, and a payment of interest on December 31 of each year, beginning in 1997, equal to a percentage of the total gross income derived from the property in that year. However, the total interest payable on the debt instrument over its entire term is limited to a maximum of \$50,000. Assume that on December 31, 1996, the short-term applicable Federal rate is 4 percent, compounded annually, and the mid-term applica-

ble Federal rate is 5 percent, compounded annually.

(ii) *Treatment of noncontingent payment as separate contract.* Each payment of interest is a contingent payment. Accordingly, under paragraph (a) of this section, for purposes of applying section 483 to the debt instrument, the right to the noncontingent payment of \$200,000 is treated as a separate contract. The amount of unstated interest on this separate contract is equal to \$43,295, which is the amount by which the payment (\$200,000) exceeds the present value of the payment (\$156,705), calculated using the test rate of 5 percent, compounded annually. The \$200,000 payment is thus treated as consisting of a payment of interest of \$43,295 and a payment of principal of \$156,705. The interest is includible in A's gross income, and deductible by B, under their respective methods of accounting.

(iii) *Treatment of contingent payments.* Assume that the amount of the contingent payment that is paid on December 31, 1997, is \$20,000. Under paragraph (a) of this section, the \$20,000 payment is treated as a payment of principal of \$19,231 (the present value, as of the date of sale, of the \$20,000 payment, calculated using a test rate equal to 4 percent, compounded annually) and a payment of interest of \$769. The \$769 interest payment is includible in A's gross income, and deductible by B, in their respective taxable years in which the payment occurs. The amount treated as principal gives B additional basis in the property on December 31, 1997. The remaining contingent payments on the debt instrument are accounted for similarly, using a test rate of 4 percent, compounded annually, for the payments made on December 31, 1998, and December 31, 1999, and a test rate of 5 percent, compounded annually, for the payments made on December 31, 2000, and December 31, 2001.

*Example 2. Contingent stock payout—(i) Facts.* M Corporation and N Corporation each owns one-half of the stock of O Corporation. On December 31, 1996, pursuant to a reorganization qualifying under section 368(a)(1)(B), M acquires the one-half interest of O held by N in exchange for 30,000 shares of M voting stock and a non-assignable right to receive up to 10,000 additional shares of M's voting stock during the next 3 years, provided the net profits of O exceed certain amounts specified in the contract. No interest is provided for in the contract. No additional shares are received in 1997 or in 1998. In 1999, the annual earnings of O exceed the specified amount, and, on December 31, 1999, an additional 3,000 M voting shares are transferred to N. The fair market value of the 3,000 shares on December 31, 1999, is \$300,000. Assume that on December 31, 1996, the short-term applicable Federal rate is 4 percent, compounded annually. M and N are calendar year taxpayers.

(ii) *Allocation of interest.* Section 1274 does not apply to the right to receive the additional shares because the right is not a debt instrument for federal income tax purposes. As a result, the transfer of the 3,000 M voting shares to N is a deferred payment subject to section 483 and a portion of the shares is treated as unstated interest under that section. The amount of interest allocable to the shares is equal to the excess of \$300,000 (the fair market value of the shares on December 31, 1999) over \$266,699 (the present value of \$300,000, determined by discounting the payment at the test rate of 4 percent, compounded annually, from December 31, 1999, to December 31, 1996). As a result, the amount of interest allocable to the payment of the shares is \$33,301 (\$300,000-\$266,699). Both M and N take the interest into account in 1999.

(c) *Effective date.* This section applies to sales and exchanges that occur on or after August 13, 1996.

[T.D. 8674, 61 FR 30138, June 14, 1996]

REGULATIONS APPLICABLE FOR TAXABLE YEARS BEGINNING ON OR BEFORE APRIL 21, 1993

**§ 1.482-1A Allocation of income and deductions among taxpayers.**

(a) *Definitions.* When used in this section and in § 1.482-2—

(1) The term “organization” includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or the regulations thereunder), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return.

(2) The term “trade” or “business” includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.

(3) The term “controlled” includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(4) The term “controlled taxpayer” means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

(5) The terms “group” and “group of controlled taxpayers” mean the organizations, trades, or businesses owned or controlled by the same interests.

(6) The term “true taxable income” means, in the case of a controlled taxpayer, the taxable income (or, as the case may be, any item or element affecting taxable income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement, or other act) dealt with the other member or members of the group at arm’s length. It does not mean the income, the deductions, the credits, the allowances, or the item or element of income, deductions, credits, or allowances, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

(b) *Scope and purpose.* (1) The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of