

§ 1.467-2

26 CFR Ch. I (4-1-04 Edition)

(i) [Reserved]

(j) *Computational rules.* For purposes of this section and §§1.467-2 through 1.467-9, the following rules apply—

(1) *Counting conventions.* Any reasonable counting convention may be used (for example, 30 days per month/360 days per year) to determine the length of a rental period or to perform any computation. Rental periods of the same descriptive length, for example annual, semiannual, quarterly, or monthly, may be treated as being of equal length.

(2) *Conventions regarding timing of rent and payments—(i) In general.* For purposes of determining present values and yield only, except as otherwise provided in this section and §§1.467-2 through 1.467-8—

(A) The rent allocated to a rental period is taken into account on the last day of the rental period;

(B) Any amount payable during the first half of the first rental period is treated as payable on the first day of that rental period;

(C) Any amount payable during the first half of any other rental period is treated as payable on the last day of the preceding rental period;

(D) Any amount payable during the second half of a rental period is treated as payable on the last day of the rental period; and

(E) Any amount payable at the midpoint of a rental period is treated, in applying this paragraph (j)(2), as an amount payable during the first half of the rental period.

(ii) *Time amount is payable.* For purposes of this section and §§1.467-2 through 1.467-9, an amount is payable on the last day for timely payment (that is, the last day such amount may be paid without incurring interest, computed at an arm's-length rate, a substantial penalty, or other substantial detriment (such as giving the lessor the right to terminate the agreement, bring an action to enforce payment, or exercise other similar remedies under the terms of the agreement or applicable law)). This paragraph (j)(2)(ii) applies to section 467 rental agreements entered into after March 6, 2001. However, taxpayers may choose to apply this paragraph (j)(2)(ii) to any rental agreement that is described in

§ 1.467-9(a) and is entered into on or before March 6, 2001.

(3) *Annualized fixed rent.* Annualized fixed rent is determined by multiplying the fixed rent allocated to the rental period under paragraph (c)(2)(ii) of this section by the number of periods of the rental period's length in a calendar year. Thus, if the fixed rent allocated to a rental period is \$10,000 and the rental period is one month, the annualized fixed rent for that rental period is \$120,000 (\$10,000 times 12).

(4) *Allocation of fixed rent within a period.* A rental agreement that allocates fixed rent to any period is treated as allocating fixed rent ratably within that period. Thus, if a rental agreement provides that \$120,000 is allocated to each calendar year in the lease term, \$10,000 of rent is allocated to each calendar month.

(5) *Rental period length.* Except as provided in § 1.467-3(d)(1) (relating to agreements for which constant rental accrual is required), rental periods may be of any length, may vary in length, and may be different as between the lessor and the lessee as long as—

(i) The rental periods are one year or less, cover the entire lease term, and do not overlap;

(ii) Each scheduled payment under the rental agreement (other than a payment scheduled to occur before or after the lease term) occurs within 30 days of the beginning or end of a rental period; and

(iii) In the case of a rental agreement that does not provide a specific allocation of fixed rent, the rental periods selected do not cause the agreement to be treated as a section 467 rental agreement unless all alternative rental period schedules would result in such treatment.

[T.D. 8820, 64 FR 26853, May 18, 1999, as amended by T.D. 8917, 66 FR 1039, Jan. 5, 2001]

**§ 1.467-2 Rent accrual for section 467 rental agreements without adequate interest.**

(a) *Section 467 rental agreements for which proportional rental accrual is required.* Under § 1.467-1(d)(2)(ii), the fixed rent for each rental period is the proportional rental amount, computed under paragraph (c) of this section, if—

(1) The section 467 rental agreement is not a disqualified leaseback or long-term agreement under §1.467-3(b); and

(2) The section 467 rental agreement does not provide adequate interest on fixed rent under paragraph (b) of this section.

(b) *Adequate interest on fixed rent*—(1) *In general.* A section 467 rental agreement provides adequate interest on fixed rent if, disregarding any contingent rent—

(i) The rental agreement has no deferred or prepaid rent as described in §1.467-1(c)(3);

(ii) The rental agreement has deferred or prepaid rent, and—

(A) The rental agreement provides interest (the stated rate of interest) on deferred or prepaid fixed rent at a single fixed rate (as defined in §1.1273-1(c)(1)(iii));

(B) The stated rate of interest on fixed rent is no lower than 110 percent of the applicable Federal rate (as defined in paragraph (e)(3) of this section);

(C) The amount of deferred or prepaid fixed rent on which interest is charged is adjusted at least annually to reflect the amount of deferred or prepaid fixed rent as of a date no earlier than the date of the preceding adjustment and no later than the date of the succeeding adjustment; and

(D) The rental agreement requires interest to be paid or compounded at least annually;

(iii) The rental agreement provides for deferred rent but no prepaid rent, and the sum of the present values (within the meaning of paragraph (d) of this section) of all amounts payable by the lessee as fixed rent (and interest, if any, thereon) is equal to or greater than the sum of the present values of the fixed rent allocated to each rental period; or

(iv) The rental agreement provides for prepaid rent but no deferred rent, and the sum of the present values of all amounts payable by the lessee as fixed rent, plus the sum of the negative present values of all amounts payable by the lessor as interest, if any, on prepaid fixed rent, is equal to or less than the sum of the present values of the fixed rent allocated to each rental period.

(2) *Section 467 rental agreements that provide for a variable rate of interest.* For purposes of the adequate interest test under paragraph (b)(1) of this section, if a section 467 rental agreement provides for variable interest, the rental agreement is treated as providing for fixed rates of interest on deferred or prepaid fixed rent equal to the fixed rate substitutes (determined in the same manner as under §1.1275-5(e), treating the agreement date as the issue date) for the variable rates called for by the rental agreement. For purposes of this section, a rental agreement provides for variable interest if all stated interest provided by the agreement is paid or compounded at least annually at a rate or rates that meet the requirements of §1.1275-5(a)(3)(i)(A) or (B) and (a)(4).

(3) *Agreements with both deferred and prepaid rent.* If an agreement has both deferred and prepaid rent, the agreement provides adequate interest under paragraph (b)(1) of this section if the conditions set forth in paragraph (b)(1)(ii)(A) through (D) of this section are met for both the prepaid and the deferred rent. For purposes of this paragraph (b)(3), an agreement will be considered to meet the condition set forth in paragraph (b)(1)(ii)(A) of this section if the agreement provides a single fixed rate of interest on the deferred rent and a single fixed rate of interest on the prepaid rent, even if those rates are not the same. This paragraph (b)(3) applies to section 467 rental agreements entered into after March 6, 2001. However, taxpayers may choose to apply this paragraph (b)(3) to any rental agreement that is described in §1.467-9(a) and is entered into on or before March 6, 2001.

(c) *Computation of proportional rental amount*—(1) *In general.* The proportional rental amount for a rental period is the amount of fixed rent allocated to the rental period under §1.467-1(c)(2)(ii), multiplied by a fraction. The numerator of the fraction is the sum of the present values of the amounts payable under the terms of the section 467 rental agreement as fixed rent and interest thereon. The denominator of the fraction is the sum of the present values of the fixed rent allocated to each

rental period under the rental agreement.

(2) *Section 467 rental agreements that provide for a variable rate of interest.* To calculate the proportional rental amount for a section 467 rental agreement that provides for a variable rate of interest, see § 1.467-5.

(d) *Present value.* For purposes of determining adequate interest under paragraph (b) of this section or the proportional rental amount under paragraph (c) of this section, the present value of any amount is determined using a discount rate equal to 110 percent of the applicable Federal rate. In general, present values are determined as of the first day of the first rental period in the lease term. However, if a section 467 rental agreement calls for payments of fixed rent prior to the lease term, present values are determined as of the first day a fixed rent payment is called for by the agreement. For purposes of the present value determination under paragraph (b)(1)(iv) of this section, the fixed rent allocated to a rental period must be discounted from the first day of the rental period. For other conventions and rules relating to the determination of present value, see § 1.467-1(g) and (j).

(e) *Applicable Federal rate—(1) In general.* The applicable Federal rate for a section 467 rental agreement is the applicable Federal rate in effect on the agreement date. The *applicable Federal rate* for a rental agreement means—

- (i) The Federal short-term rate if the term of the rental agreement is not over 3 years;
- (ii) The Federal mid-term rate if the term of the rental agreement is over 3 years but not over 9 years; and
- (iii) The Federal long-term rate if the term of the rental agreement is over 9 years.

(2) *Source of applicable Federal rates.* The Internal Revenue Service publishes the applicable Federal rates, based on annual, semiannual, quarterly, and monthly compounding, each month in the Internal Revenue Bulletin (see § 601.601(d) of this chapter). However, the applicable Federal rates may be based on any compounding assumption. To convert a rate based on one compounding assumption to an equivalent rate based on a different

compounding assumption, see § 1.1272-1(j), *Example 1*.

(3) *110 percent of applicable Federal rate.* For purposes of § 1.467-1, this section and §§ 1.467-3 through 1.467-9, 110 percent of the applicable Federal rate means 110 percent of the applicable Federal rate based on semiannual compounding or any rate based on a different compounding assumption that is equivalent to 110 percent of the applicable Federal rate based on semiannual compounding. The Internal Revenue Service publishes 110 percent of the applicable Federal rates, based on annual, semiannual, quarterly, and monthly compounding, each month in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(4) *Term of the section 467 rental agreement—(i) In general.* For purposes of determining the applicable Federal rate under this paragraph (e), the term of the section 467 rental agreement includes the lease term, any period before the lease term beginning with the first day an amount of fixed rent is payable under the terms of the rental agreement, and any period after the lease term ending with the last day an amount of fixed rent or interest thereon is payable under the rental agreement.

(ii) *Section 467 rental agreements with variable interest.* If a section 467 rental agreement provides variable interest on deferred or prepaid fixed rent, the term of the rental agreement for purposes of calculating the applicable Federal rate is the longest period between interest rate adjustment dates, or, if the rental agreement provides an initial fixed rate of interest on deferred or prepaid fixed rent, the period between the agreement date and the last day the fixed rate applies, if this period is longer. If, as described in § 1.1274-4(c)(2)(ii), the rental agreement provides for a qualified floating rate (as defined in § 1.1275-5(b)) that in substance resembles a fixed rate, the applicable Federal rate is determined by reference to the lease term.

(f) *Examples.* The following examples illustrate the application of this section. In each of these examples it is assumed that the rental agreement is not a disqualified leaseback or long-term

agreement subject to constant rental accrual. The examples are as follows:

*Example 1.* (i) C agrees to lease property from D for five years beginning on January 1, 2000, and ending on December 31, 2004. The section 467 rental agreement provides that rent of \$100,000 accrues in each calendar year in the lease term and that rent of \$500,000 plus \$120,000 of interest is payable on December 31, 2004. Assume that the parties select the calendar year as the rental period and that 110 percent of the applicable Federal rate is 10 percent, compounded annually.

(ii) The rental agreement has deferred rent under §1.467-1(c)(3)(i) because the fixed rent allocated to calendar years 2000, 2001, and 2002 is not paid until 2004. In addition, because the rental agreement does not state an interest rate, the rental agreement does not satisfy the requirements of paragraph (b)(1)(ii) of this section.

(iii)(A) Because the rental agreement has deferred fixed rent and no prepaid rent, the agreement has adequate interest only if the present value test provided in paragraph (b)(1)(iii) of this section is met. The present value of all fixed rent and interest payable under the rental agreement is \$384,971.22, determined as follows:  $\$620,000/(1.10)^5 = \$384,971.22$ . The present value of all fixed rent allocated under the rental agreement (discounting the amount of fixed rent allocated to a rental period from the last day of the rental period) is \$379,078.68, determined as follows:

$$\$379,078.68 = \$100,000 \times \frac{1 - (1.10)^{-5}}{.10}$$

(B) The rental agreement provides adequate interest on fixed rent because the present value of the single amount payable under the section 467 rental agreement exceeds the sum of the present values of fixed rent allocated.

(iv) For an example illustrating the computation of the yield on the rental agreement and the allocation of the interest and rent provided for under the rental agreement, see §1.467-4(f), *Example 2*.

*Example 2.* (i) E and F enter into a section 467 rental agreement for the lease of equipment beginning on January 1, 2000, and ending on December 31, 2004. The rental agreement provides that rent of \$100,000 accrues for each calendar month during the lease term. All rent is payable on December 31, 2004, together with interest on accrued rent at a qualified floating rate set at a current

value (as defined in §1.1275-5(a)(4)) that is compounded at the end of each calendar month and adjusted at the beginning of each calendar month throughout the lease term. Therefore, the rental agreement provides for variable interest within the meaning of paragraph (b)(2) of this section.

(ii) On the agreement date the qualified floating rate is 7.5 percent, and 110 percent of the applicable Federal rate, as defined in paragraph (e)(3) of this section, based on monthly compounding, is 7 percent. Under paragraph (b)(2) of this section, the fixed rate substitute for the qualified floating rate is 7.5 percent and the agreement is treated as providing for interest at this fixed rate for purposes of determining whether adequate interest is provided under paragraph (b) of this section. Accordingly, the requirements of paragraph (b)(1)(ii) of this section are satisfied, and the rental agreement has adequate interest.

*Example 3.* (i) X and Y enter into a section 467 rental agreement for the lease of real property beginning on January 1, 2000, and ending on December 31, 2002. The rental agreement provides that rent of \$800,000 is allocable to 2000, \$1,000,000 is allocable to 2001, and \$1,200,000 is allocable to 2002. Under the rental agreement, Y must make a \$3,000,000 payment on December 31, 2002. Assume that both X and Y choose the calendar year as the rental period, X and Y are calendar year taxpayers, and 110 percent of the applicable Federal rate is 8.5 percent compounded annually.

(ii) The rental agreement fails to provide adequate interest under paragraph (b)(1) of this section. Therefore, under §1.467-1(d)(2)(ii), the fixed rent for each rental period is the proportional rental amount.

(iii)(A) The proportional rental amount is computed under paragraph (c) of this section. Because the rental agreement does not call for any fixed rent payments prior to the lease term, under paragraph (d) of this section, the present value is determined as of the first day of the first rental period in the lease term. The present value of the single amount payable by the lessee under the rental agreement is computed as follows:

$$\$2,348,724.30 = \frac{\$3,000,000}{(1+.085)^3}$$

(B) The sum of the present values of the fixed rent allocated to each rental period (discounting the fixed rent allocated to a rental period from the last day of such rental period) is computed as follows:

$$\$2,526,272.20 = \frac{\$800,000}{(1+.085)} + \frac{\$1,000,000}{(1+.085)^2} + \frac{\$1,200,000}{(1+.085)^3}$$

§ 1.467-3

(C) Thus, the fraction for determining the proportional rental amount is  $.9297194$  ( $\$2,348,724.30/\$2,526,272.20$ ). The section 467 interest for each of the taxable years within the lease term is computed and taken into account as provided in § 1.467-4. The section 467 rent for each of the taxable years within the lease term is as follows:

Taxable year	Section 467 rent
2000 .....	\$743,775.52 ( $\$ 800,000 \times .9297194$ ).
2001 .....	929,719.40 ( $\$1,000,000 \times .9297194$ ).
2002 .....	1,115,663.28 ( $\$1,200,000 \times .9297194$ ).

[T.D. 8820, 64 FR 26859, May 18, 1999, as amended by T.D. 8917, 66 FR 1040, Jan. 5, 2001]

**§ 1.467-3 Disqualified leasebacks and long-term agreements.**

(a) *General rule.* Under § 1.467-1(d)(2)(i), constant rental accrual (as described under paragraph (d) of this section) must be used to determine the fixed rent for each rental period in the lease term if the section 467 rental agreement is a disqualified leaseback or long-term agreement within the meaning of paragraph (b) of this section. Constant rental accrual may not be used in the absence of a determination by the Commissioner, pursuant to paragraph (b)(1)(ii) of this section, that the rental agreement is disqualified. Such determination may be made either on a case-by-case basis or in regulations or other guidance published by the Commissioner (see § 601.601(d)(2) of this chapter) providing that a certain type or class of leaseback or long-term agreement will be treated as disqualified and subject to constant rental accrual.

(b) *Disqualified leaseback or long-term agreement—(1) In general.* A leaseback (as defined in paragraph (b)(2) of this section) or a long-term agreement (as defined in paragraph (b)(3) of this section) is disqualified only if—

(i) A principal purpose for providing increasing or decreasing rent is the avoidance of Federal income tax (as described in paragraph (c) of this section);

(ii) The Commissioner determines that, because of the tax avoidance purpose, the agreement should be treated as a disqualified leaseback or long-term agreement; and

(iii) For section 467 rental agreements entered into before July 19, 1999, the amount determined with respect to the rental agreement under § 1.467-1(c)(4) (relating to the exception for rental agreements involving total payments of \$250,000 or less) exceeds \$2,000,000.

(2) *Leaseback.* A section 467 rental agreement is a leaseback if the lessee (or a related person) had any interest (other than a de minimis interest) in the property at any time during the two-year period ending on the agreement date. For this purpose, interests in property include options and agreements to purchase the property (whether or not the lessee or related person was considered the owner of the property for Federal income tax purposes) and, in the case of subleased property, any interest as a sublessor.

(3) *Long-term agreement—(i) In general.* A section 467 rental agreement is a long-term agreement if the lease term exceeds 75 percent of the property's statutory recovery period.

(ii) *Statutory recovery period—(A) In general.* The term statutory recovery period means—

(1) In the case of property depreciable under section 168, the applicable period determined under section 467(e)(3)(A);

(2) In the case of land, 19 years; and

(3) In the case of any other tangible property, the period that would apply under section 467(e)(3)(A) if the property were property to which section 168 applied.

(B) *Special rule for rental agreements relating to properties having different statutory recovery periods.* In the case of a rental agreement relating to two or more related properties that have different statutory recovery periods, the statutory recovery period for purposes of paragraph (b)(3)(ii)(A) of this section is the weighted average, based on the fair market values of the properties on the agreement date, of the statutory recovery periods of each of the properties.

(c) *Tax avoidance as principal purpose for increasing or decreasing rent—(1) In general.* In determining whether a principal purpose for providing increasing or decreasing rent is the avoidance of Federal income tax, all relevant facts