

§ 1.1274-3

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

§ 1.1274-3 Potentially abusive situations defined.

(a) *In general.* For purposes of section 1274, a potentially abusive situation means—

(1) A tax shelter (as defined in section 6662(d)(2)(C)(ii)); or

(2) Any other situation involving—

(i) A recent sales transaction;

(ii) Nonrecourse financing;

(iii) Financing with a term in excess of the useful life of the property; or

(iv) A debt instrument with clearly excessive interest.

(b) *Operating rules—(1) Debt instrument exchanged for nonrecourse financing.* Nonrecourse financing does not include an exchange of a nonrecourse debt instrument for an outstanding recourse or nonrecourse debt instrument.

(2) *Nonrecourse debt with substantial down payment.* Nonrecourse financing does not include a sale or exchange of a real property interest financed by a nonrecourse debt instrument if, in addition to the nonrecourse debt instrument, the purchaser makes a down payment in money that equals or exceeds 20 percent of the total stated purchase price of the real property interest. For purposes of the preceding sentence, a real property interest means any interest, other than an interest solely as a creditor, in real property.

(3) *Clearly excessive interest.* Interest on a debt instrument is clearly excessive if the interest, in light of the terms of the debt instrument and the creditworthiness of the borrower, is clearly greater than the arm's length amount of interest that would have been charged in a cash lending transaction between the same two parties.

(c) *Other situations to be specified by Commissioner.* The Commissioner may designate in the Internal Revenue Bulletin situations that, although described in paragraph (a)(2) of this section, will not be treated as potentially abusive because they do not have the effect of significantly misstating basis or amount realized (see § 601.601(d)(2)(ii) of this chapter).

(d) *Consistency rule.* The issuer's determination that the debt instrument is or is not issued in a potentially abusive situation is binding on all holders of the debt instrument. However, the issuer's determination is not binding

on a holder who explicitly discloses a position that is inconsistent with the issuer's determination. Unless otherwise prescribed by the Commissioner, the disclosure must be made on a statement attached to the holder's timely filed Federal income tax return for the taxable year that includes the acquisition date of the debt instrument. See § 1.1275-2(e) for rules relating to the issuer's obligation to disclose certain information to holders.

[T.D. 8517, 59 FR 4822, Feb. 2, 1994]

§ 1.1274-4 Test rate.

(a) *Determination of test rate of interest—(1) In general—(i) Test rate is the 3-month rate.* Except as provided in paragraph (a)(2) of this section, the test rate of interest for a debt instrument issued in consideration for the sale or exchange of property is the 3-month rate.

(ii) *The 3-month rate.* Except as provided in paragraph (a)(1)(iii) of this section, the 3-month rate is the lower of—

(A) The lowest applicable Federal rate (based on the appropriate compounding period) in effect during the 3-month period ending with the first month in which there is a binding written contract that substantially sets forth the terms under which the sale or exchange is ultimately consummated; or

(B) The lowest applicable Federal rate (based on the appropriate compounding period) in effect during the 3-month period ending with the month in which the sale or exchange occurs.

(iii) *Special rule if there is no binding written contract.* If there is no binding written contract that substantially sets forth the terms under which the sale or exchange is ultimately consummated, the 3-month rate is the lowest applicable Federal rate (based on the appropriate compounding period) in effect during the 3-month period ending with the month in which the sale or exchange occurs.

(2) *Test rate for certain debt instruments—(i) Sale-leaseback transactions.* Under section 1274(e) (relating to certain sale-leaseback transactions), the test rate is 110 percent of the 3-month rate determined under paragraph (a)(1) of this section. For purposes of section