

under paragraph (c)(3)(ii)(A) of this section. Accordingly, based on all the facts and circumstances, the adjustment provision did not have as one of its principal purposes the avoidance of Federal income tax, and thus the long-term agreement will not be treated as disqualified.

*Example 6.* (i) X and Y enter into a leaseback for a 5-year lease of personal property beginning on January 1, 1998, and ending on December 31, 2002. The rental agreement provides that \$0 of rent is allocated to years 1998, 1999, and 2000, and that rent of \$17,500,000 is allocated to years 2001 and 2002. The rental agreement provides that the rent allocated to each year is payable on December 31 of that year. Assume all rental periods are the calendar year. Assume also that 110 percent of the applicable Federal rate based on annual compounding is 12 percent.

(ii)(A) If the Commissioner determines that the leaseback is disqualified, the constant rental amount is computed as follows:

(B) Step 1 in calculating the constant rental amount is to determine the present value of the two payments due under the rental agreement as follows:

$$\$21,051,536 = \frac{\$17,500,000}{(1.12)^4} + \frac{\$17,500,000}{(1.12)^5}$$

(iii) Because no amounts of rent are payable before the lease term, Step 2 in calculating the constant rental amount is to determine the present value as of the first day of the lease term of \$1 to be received at the end of each rental period during the lease term. This results in a present value of \$3.6047762. In Step 3 the amount determined in Step 1 is divided by the number of dollars determined in Step 2. Thus, the constant rental amount is \$5,839,901 for each calendar year during the lease term computed as follows:

$$\$5,839,901 = \frac{\$21,051,536}{3.6047762}$$

[T.D. 8820, 64 FR 26860, May 18, 1999, as amended by T.D. 8917, 66 FR 1040, Jan. 5, 2001]

**§ 1.467-4 Section 467 loan.**

(a) *In general*—(1) *Overview.* Except as provided in paragraph (a)(2) of this section, the section 467 loan rules of this section apply to a section 467 rental agreement if, as of the first day of a rental period, there is a difference between the amount of fixed rent payable under the rental agreement on or before the first day and the amount of fixed rent required to be accrued in accordance with § 1.467-1(d)(2) before the first day. Paragraph (b) of this section

provides rules for computing the principal balance of a section 467 loan at the beginning of any rental period. The principal balance of a section 467 loan may be positive or negative. For Federal tax purposes, if the principal balance is positive, the amount represents a loan from the lessor to the lessee, and if the principal balance is negative, the amount represents a loan from the lessee to the lessor.

(2) *No section 467 loan in the case of certain section 467 rental agreements.* Except as provided in paragraphs (a)(3) and (4) of this section, this section does not apply to section 467 rental agreements that provide adequate interest under § 1.467-2(b)(1)(i) (agreements with no deferred or prepaid rent) or § 1.467-2(b)(1)(ii) (agreements with deferred or prepaid rent that provide adequate stated interest at a single fixed rate).

(3) *Rental agreements subject to constant rental accrual.* Notwithstanding the provisions of paragraph (a)(2) of this section, this section applies to rental agreements subject to constant rental accrual under § 1.467-3 (relating to disqualified leasebacks or long-term agreements).

(4) *Special rule in applying the provisions of § 1.467-7(e), (f), or (g).* Notwithstanding the provisions of paragraph (a)(2) of this section, section 467 loan balances must be computed for section 467 rental agreements that are not subject to constant rental accrual under § 1.467-3 and that provide adequate interest under § 1.467-2(b)(1)(i) or (ii), but only for purposes of applying the provisions of § 1.467-7(e) (relating to dispositions of property subject to a section 467 rental agreement), § 1.467-7(f) (relating to assignments by lessees and lessee-financed renewals), and § 1.467-7(g) (relating to modifications of rental agreements).

(b) *Principal balance*—(1) *In general.* Except as provided in paragraph (b)(2) of this section or in § 1.467-7(e), (f), or (g), the principal balance of the section 467 loan at the beginning of a rental period equals—

(i) The fixed rent accrued in preceding rental periods;

(ii) Increased by the sum of—

(A) The interest on fixed rent includable in the gross income of the lessor for preceding rental periods; and

(B) Any amount payable by the lessor on or before the first day of the rental period as interest on prepaid fixed rent; and

(iii) Decreased by the sum of—

(A) The interest on prepaid fixed rent includible in the gross income of the lessee for preceding rental periods; and

(B) Any amount payable by the lessee on or before the first day of the rental period as fixed rent or interest thereon.

(2) *Section 467 rental agreements that provide for prepaid fixed rent and adequate interest.* If a section 467 rental agreement calls for prepaid fixed rent and provides adequate interest under § 1.467-2(b)(1)(iv), the principal balance of the section 467 loan at the beginning of a rental period equals the principal balance determined under paragraph (b)(1) of this section, plus the fixed rent accrued for that rental period.

(3) *Timing of payments.* For purposes of this paragraph (b), the day on which an amount is payable is determined under the rules of § 1.467-1(j)(2)(i)(B) through (E) and § 1.467-1(j)(2)(ii).

(c) *Yield—(1) In general—(i) Method of determining yield.* Except as provided in paragraphs (c)(2) and (3) of this section, the yield of a section 467 loan is the discount rate at which the sum of the present values of all amounts payable by the lessee as fixed rent and interest on fixed rent, plus the sum of the present values of all amounts payable by the lessor as interest on prepaid fixed rent, equals the sum of the present values of the fixed rent that accrues in accordance with § 1.467-1(d)(2). The yield must be constant over the term of the section 467 rental agreement and, when expressed as a percentage, must be calculated to at least two decimal places.

(ii) *Method of stating yield.* In determining the section 467 interest for a rental period, the yield of the section 467 loan must be stated appropriately by taking into account the length of the rental period. Section 1.1272-1(j), *Example 1*, provides a formula for converting a yield based on a period of one length to an equivalent yield based on a period of a different length.

(iii) *Rounding adjustments.* Any adjustment necessary to eliminate the section 467 loan because of rounding the yield to two or more decimal places

must be taken into account as an adjustment to the section 467 interest for the final rental period determined as provided in paragraph (e) of this section.

(2) *Yield of section 467 rental agreements for which constant rental amount or proportional rental amount is computed.* In the case of a section 467 rental agreement to which § 1.467-1(d)(2)(i) or (ii) applies, the yield of the section 467 loan equals 110 percent of the applicable Federal rate (based on a compounding period equal to the length of the rental period).

(3) *Yield for purposes of applying paragraph (a)(4) of this section.* For purposes of applying paragraph (a)(4) of this section, the yield of the section 467 loan balance of any party, or prior party, to a section 467 rental agreement for a period is the same for all parties and is the yield that results in the net accrual of positive or negative interest for that period equal to the amount of such interest that accrues under the terms of the rental agreement for that period. For example, if property subject to a section 467 rental agreement is sold (transferred) and the beginning section 467 loan balance of the transferor (as described in § 1.467-7(e)(2)(i)) is positive and the beginning section 467 loan balance of the transferee (as described in § 1.467-7(e)(2)(ii)) is negative, the yield on each of these loan balances for any period is the same for all parties and is the yield that results in the net accrual of positive or negative interest, taking into account the aggregate positive or negative interest on the section 467 loan balances of both the transferor and transferee, equal to the amount of such interest that accrues under the terms of the rental agreement for that period.

(4) *Determination of present values.* The rules for determining present value in computing the yield of a section 467 loan are the same as those provided in § 1.467-2(d) for computing the proportional rental amount.

(d) *Contingent payments.* Except as otherwise required, contingent payments are not taken into account in calculating either the yield or the principal balance of a section 467 loan.

(e) *Section 467 rental agreements that call for payments before or after the lease*

*term.* If a section 467 rental agreement calls for the payment of fixed rent or interest thereon before the beginning of the lease term, this section is applied by treating the period beginning on the first day an amount is payable and ending on the day before the beginning of the first rental period of the lease term as one or more rental periods. If a rental agreement calls for the payment of fixed rent or interest thereon after the end of the lease term, this section is applied by treating the period beginning on the day after the end of the last rental period of the lease term and ending on the last day an amount of fixed rent or interest thereon is payable as one or more rental periods. Rental period length for the period before the lease term or after the lease term is determined in accordance with the rules of § 1.467-1(j)(5).

(f) *Examples.* The following examples illustrate the application of this section:

*Example 1.* (i)(A) A leases property to B for a three-year period beginning on January 1, 2000, and ending on December 31, 2002. The section 467 rental agreement has the following rent allocation schedule and payment schedule:

|            | Rent allocation | Payment     |
|------------|-----------------|-------------|
| 2000 ..... | \$400,000       | .....       |
| 2001 ..... | 600,000         | .....       |
| 2002 ..... | 800,000         | \$1,800,000 |

(B) The rental agreement requires a \$1.8 million payment to be made on December 31, 2002, but does not provide for interest on deferred rent. Assume A and B choose the calendar year as the rental period length and that 110 percent of the applicable Federal rate based on annual compounding is 10 percent. Assume also that the agreement is not a leaseback or long-term agreement and, therefore, is not subject to constant rental accrual.

(ii) Because the section 467 rental agreement does not provide adequate interest under § 1.467-2(b) and is not subject to constant rental accrual, the fixed rent that accrues during each rental period is the proportional rental amount as described in § 1.467-2(c). The proportional rental amounts for each rental period are as follows:

|            |              |
|------------|--------------|
| 2000 ..... | \$370,370.37 |
| 2001 ..... | 555,555.56   |
| 2002 ..... | 740,740.73   |

(iii) A section 467 loan arises at the beginning of the second rental period because the rent payable on or before that day (zero) is

less than the fixed rent accrued under § 1.467-1(d)(2) in all preceding rental periods (\$370,370.37). Under paragraph (c)(2) of this section, the yield of the loan is equal to 110 percent of the applicable Federal rate (10 percent compounded annually). Because no payments are treated as made on or before the first day of the second rental period, the principal balance of the loan at the beginning of the second rental period is \$370,370.37. The interest for the second rental period on fixed rent is \$37,037.04 (.10 × \$370,370.37) and, under § 1.467-1(e)(3), is treated as interest income of the lessor and as an interest expense of the lessee.

(iv) Because no payments are made on or before the first day of the third rental period, the principal balance of the loan at the beginning of the third rental period is equal to the fixed rent accrued during the first and second rental periods plus the lessor's interest income on fixed rent for the second rental period (\$962,962.97 = \$370,370.37 + \$555,555.56 + \$37,037.04). The interest for the third rental period on fixed rent is \$96,296.30 (.10 × \$962,962.97). Thus, the sum of the fixed rent and interest on fixed rent for the three rental periods is equal to the total amount paid over the lease term (first year fixed rent accrual, \$370,370.37, plus second year fixed rent and interest accrual, \$555,555.56 + \$37,037.04, plus third year fixed rent and interest accrual, \$740,740.73 + \$96,296.30, equals \$1,800,000). B takes the amounts of interest and rent into account as interest and rent expense, respectively, and A takes such amounts into account as interest and rent income, respectively, for the calendar years identified above, regardless of their respective overall methods of accounting.

*Example 2.* (i) The facts are the same as in *Example 1*, § 1.467-2(f). 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. The parties select the calendar year as the rental period, and 110 percent of the applicable Federal rate is 10 percent, compounded annually. The rental agreement has deferred rent but provides adequate interest on fixed rent.

(ii)(A) Pursuant to paragraph (c)(1) of this section, the yield of the section 467 loan is 10.775078%, compounded annually. The following is a schedule of the rent allocable to each rental period during the lease term, the balance of the section 467 loan as of the end of each rental period (determined, in the case of the calendar year 2004, without regard to the single payment of rent and interest in the amount of \$620,000 payable on the last day of the lease term), and the interest on the section 467 loan allocable to each rental period:

| Calendar year | Section 467 interest | Section 467 rent | Section 467 loan balance |
|---------------|----------------------|------------------|--------------------------|
| 2000 .....    | \$0                  | \$100,000.00     | \$100,000.00             |
| 2001 .....    | 10,775.08            | 100,000.00       | 210,775.08               |
| 2002 .....    | 22,711.18            | 100,000.00       | 333,486.26               |
| 2003 .....    | 35,933.41            | 100,000.00       | 469,419.67               |
| 2004 .....    | 50,580.33            | 100,000.00       | 620,000.00               |

(B) C takes the amounts of interest and rent into account as expense and D takes such amounts into account as income for the calendar years identified above, regardless of their respective overall methods of accounting.

[T.D. 8820, 64 FR 26863, May 18, 1999]

**§ 1.467-5 Section 467 rental agreements with variable interest.**

(a) *Variable interest on deferred or prepaid rent*—(1) *In general.* This section provides rules for computing section 467 rent and interest in the case of section 467 rental agreements providing variable interest. For purposes of this section, a rental agreement provides for variable interest if the rental agreement provides for stated interest that 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). If a section 467 rental agreement provides for interest that is neither variable interest nor fixed interest, the agreement provides for contingent payments.

(2) *Exceptions.* This section is not applicable to section 467 rental agreements that provide adequate interest under § 1.467-2(b)(1)(i) (agreements with no deferred or prepaid rent) or (b)(1)(ii) (rental agreements with stated interest at a single fixed rate). The exceptions in this paragraph (a)(2) do not apply to rental agreements subject to constant rental accrual under § 1.467-3.

(b) *Variable rate treated as fixed*—(1) *In general.* If a section 467 rental agreement provides variable interest—

(i) 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 of interest on deferred or prepaid fixed rent provided by the rental agreement must be used in computing the proportional rental amount under § 1.467-2(c), the constant rental amount under § 1.467-3(d), the principal balance of a section 467 loan under § 1.467-4(b),

and the yield of a section 467 loan under § 1.467-4(c); and

(ii) The interest on fixed rent for any rental period is equal to the amount that would be determined under § 1.467-1(e)(2) if the section 467 rental agreement did not provide variable interest, using the fixed rate substitutes determined under paragraph (b)(1)(i) of this section in place of the variable rates called for by the rental agreement, plus the variable interest adjustment amount provided in paragraph (b)(2) of this section.

(2) *Variable interest adjustment amount*—(i) *In general.* The variable interest adjustment amount for a rental period equals the difference between—

(A) The amount of interest that, without regard to section 467, would have accrued during the rental period under the terms of the section 467 rental agreement; and

(B) The amount of interest that, without regard to section 467, would have accrued during the rental period under the terms of the section 467 rental agreement using the fixed rate substitutes determined under paragraph (b)(1)(i) of this section in place of the variable interest rates called for by the rental agreement.

(ii) *Positive or negative adjustment.* If the amount determined under paragraph (b)(2)(i)(A) of this section is greater than the amount determined under paragraph (b)(2)(i)(B) of this section, the variable interest adjustment amount is positive. If the amount determined under paragraph (b)(2)(i)(A) of this section is less than the amount determined under paragraph (b)(2)(i)(B) of this section, the variable interest adjustment amount is negative.

(3) *Section 467 loan balance.* The variable interest adjustment amount is not taken into account in determining the principal balance of a section 467 loan under § 1.467-4(b). Instead, the section 467 loan balance is computed as if all