

stated or unstated interest on a contract subject to section 483 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). See §§1.446-1, 1.451-1, and 1.461-1. For purposes of the preceding sentence, the amount of interest (including unstated interest) allocable to a payment under a contract to which section 483 applies is determined under §1.446-2(e).

(b) *Definitions*—(1) *Deferred payments*. For purposes of the regulations under section 483, a deferred payment means any payment that constitutes all or a part of the sales price (as defined in paragraph (b)(2) of this section), and that is due more than 6 months after the date of the sale or exchange. Except as provided in section 483(c)(2) (relating to the treatment of a debt instrument of the purchaser), a payment may be made in the form of cash, stock or securities, or other property.

(2) *Sales price*. For purposes of section 483, the sales price for any sale or exchange is the sum of the amount due under the contract (other than stated interest) and the amount of any liability included in the amount realized from the sale or exchange. See §1.1001-2. Thus, the sales price for any sale or exchange includes any amount of unstated interest under the contract.

(c) *Exceptions to and limitations on the application of section 483*—(1) *In general*. Sections 483(d), 1274(c)(4), and 1275(b) contain exceptions to and limitations on the application of section 483.

(2) *Sales price of \$3,000 or less*. Section 483(d)(2) applies only if it can be determined at the time of the sale or exchange that the sales price cannot exceed \$3,000, regardless of whether the sales price eventually paid for the property is less than \$3,000.

(3) *Other exceptions and limitations*—(i) *Certain transfers subject to section 1041*. Section 483 does not apply to any transfer of property subject to section 1041 (relating to transfers of property between spouses or incident to divorce).

(ii) *Treatment of certain obligees*. Section 483 does not apply to an obligee under a contract for the sale or exchange of personal use property (within the meaning of section 1275(b)(3)) in the

hands of the obligor and that evidences a below-market loan described in section 7872(c)(1).

(iii) *Transactions involving certain demand loans*. Section 483 does not apply to any payment under a contract that evidences a demand loan that is a below-market loan described in section 7872(c)(1).

(iv) *Transactions involving certain annuity contracts*. Section 483 does not apply to any payment under an annuity contract described in section 1275(a)(1)(B) (relating to annuity contracts excluded from the definition of debt instrument).

(v) *Options*. Section 483 does not apply to any payment under an option to buy or sell property.

(d) *Assumptions*. 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 debt instrument is treated for purposes of section 483 in a manner consistent with the rules of §1.1274-5.

(e) *Aggregation rule*. For purposes of section 483, all sales or exchanges that are part of the same transaction (or a series of related transactions) are treated as a single sale or exchange, and all contracts calling for deferred payments arising from the same transaction (or a series of related transactions) are treated as a single contract. This rule, however, generally only applies to contracts and to sales or exchanges involving a single buyer and a single seller.

(f) *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 4805, Feb. 2, 1994]

§ 1.483-2 Unstated interest.

(a) *In general*—(1) *Adequate stated interest*. For purposes of section 483, a contract has unstated interest if the contract does not provide for adequate stated interest. A contract does not provide for adequate stated interest if the sum of the deferred payments exceeds—

(i) The sum of the present values of the deferred payments and the present

values of any stated interest payments due under the contract; or

(ii) In the case of a cash method debt instrument (within the meaning of section 1274A(c)(2)) received in exchange for property in a potentially abusive situation (as defined in §1.1274-3), the fair market value of the property reduced by the fair market value of any consideration other than the debt instrument, and reduced by the sum of all principal payments that are not deferred payments.

(2) *Amount of unstated interest.* For purposes of section 483, unstated interest means an amount equal to the excess of the sum of the deferred payments over the amount described in paragraph (a)(1)(i) or (a)(1)(ii) of this section, whichever is applicable.

(b) *Operational rules—(1) In general.* For purposes of paragraph (a) of this section, rules similar to those in §1.1274-2 apply to determine whether a contract has adequate stated interest and the amount of unstated interest, if any, on the contract.

(2) *Present value.* For purposes of paragraph (a) of this section, the present value of any deferred payment or interest payment is determined by discounting the payment from the date it becomes due to the date of the sale or exchange at the test rate of interest applicable to the contract in accordance with §1.483-3.

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

Example 1. Contract that does not have adequate stated interest. On January 1, 1995, A sells B nonpublicly traded property under a contract that calls for a \$100,000 payment of principal on January 1, 2005, and 10 annual interest payments of \$9,000 on January 1 of each year, beginning on January 1, 1996. Assume that the test rate of interest is 9.2 percent, compounded annually. The contract does not provide for adequate stated interest because it does not provide for interest equal to 9.2 percent, compounded annually. The present value of the deferred payments is \$98,727.69. As a result, the contract has unstated interest of \$1,272.31 (\$100,000 - \$98,727.69).

Example 2. Contract that does not have adequate stated interest; no interest for initial short period. On May 1, 1996, A sells B nonpublicly traded property under a contract that calls for B to make a principal payment of \$200,000 on December 31, 1998, and semiannual interest payments of \$9,000, payable on June 30

and December 31 of each year, beginning on December 31, 1996. Assume that the test rate of interest is 9 percent, compounded semi-annually. Even though the contract calls for a stated rate of interest no lower than the test rate of interest, the contract does not provide for adequate stated interest because the stated rate of interest does not apply for the short period from May 1, 1996, through June 30, 1996.

Example 3. Potentially abusive situation—(i) Facts. In a potentially abusive situation, a contract for the sale of nonpublicly traded personal property calls for the issuance of a cash method debt instrument (as defined in section 1274A(c)(2)) with a stated principal amount of \$700,000, payable in 5 years. No other consideration is given. The debt instrument calls for annual payments of interest over its entire term at a rate of 9.2 percent, compounded annually (the test rate of interest applicable to the debt instrument). Thus, the present value of the deferred payment and the interest payments is \$700,000. Assume that the fair market value of the property is \$500,000.

(ii) *Amount of unstated interest.* A cash method debt instrument received in exchange for property in a potentially abusive situation provides for adequate stated interest only if the sum of the deferred payments under the instrument does not exceed the fair market value of the property. Because the deferred payment (\$700,000) exceeds the fair market value of the property (\$500,000), the debt instrument does not provide for adequate stated interest. Therefore, the debt instrument has unstated interest of \$200,000.

Example 4. Variable rate debt instrument with adequate stated interest; variable rate as of the issue date greater than the test rate—(i) Facts. A contract for the sale of nonpublicly traded property calls for the issuance of a debt instrument in the principal amount of \$75,000 due in 10 years. The debt instrument calls for interest payable semiannually at a rate of 3 percentage points above the yield on 6-month Treasury bills at the mid-point of the semiannual period immediately preceding each interest payment date. Assume that the interest rate is a qualified floating rate and that the debt instrument is a variable rate debt instrument within the meaning of §1.1275-5.

(ii) *Adequate stated interest.* Under paragraph (b)(1) of this section, rules similar to those in §1.1274-2(f) apply to determine whether the debt instrument has adequate stated interest. Assume that the test rate of interest applicable to the debt instrument is 9 percent, compounded semiannually. Assume also that the yield on 6-month Treasury bills on the date of the sale is 8.89 percent, which is greater than the yield on 6-month Treasury bills on the first date on which there is a binding written contract that substantially sets forth the terms under

which the sale is consummated. Under § 1.1274-2(f), the debt instrument is tested for adequate stated interest as if it provided for a stated rate of interest of 11.89 percent (3 percent plus 8.89 percent), compounded semiannually, payable over its entire term. Because the test rate of interest is 9 percent, compounded semiannually, and the debt instrument is treated as providing for stated interest of 11.89 percent, compounded semiannually, the debt instrument provides for adequate stated interest.

(d) *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 4806, Feb. 2, 1994]

§ 1.483-3 Test rate of interest applicable to a contract.

(a) *General rule.* For purposes of section 483, the test rate of interest for a contract is the same as the test rate that would apply under § 1.1274-4 if the contract were a debt instrument. Paragraph (b) of this section, however, provides for a lower test rate in the case of certain sales or exchanges of land between related individuals.

(b) *Lower rate for certain sales or exchanges of land between related individuals—(1) Test rate.* In the case of a qualified sale or exchange of land between related individuals (described in section 483(e)), the test rate is not greater than 6 percent, compounded semiannually, or an equivalent rate based on an appropriate compounding period.

(2) *Special rules.* The following rules and definitions apply in determining whether a sale or exchange is a qualified sale under section 483(e):

(i) *Definition of family members.* The members of an individual's family are determined as of the date of the sale or exchange. The members of an individual's family include those individuals described in section 267(c)(4) and the spouses of those individuals. In addition, for purposes of section 267(c)(4), full effect is given to a legal adoption, ancestor means parents and grandparents, and lineal descendants means children and grandchildren.

(ii) *\$500,000 limitation.* Section 483(e) does not apply to the extent that the stated principal amount of the debt in-

strument issued in the sale or exchange, when added to the aggregate stated principal amount of any other debt instruments to which section 483(e) applies that were issued in prior qualified sales between the same two individuals during the same calendar year, exceeds \$500,000. See *Example 3* of paragraph (b)(3) of this section.

(iii) *Other limitations.* Section 483(e) does not apply if the parties to a contract include persons other than the related individuals and the parties enter into the contract with an intent to circumvent the purposes of section 483(e). In addition, if the property sold or exchanged includes any property other than land, section 483(e) applies only to the extent that the stated principal amount of the debt instrument issued in the sale or exchange is attributable to the land (based on the relative fair market values of the land and the other property).

(3) *Examples.* The following examples illustrate the rules of this paragraph (b).

Example 1. On January 1, 1995, A sells land to B, A's child, for \$650,000. The contract for sale calls for B to make a \$250,000 down payment and issue a debt instrument with a stated principal amount of \$400,000. Because the stated principal amount of the debt instrument is less than \$500,000, the sale is a qualified sale and section 483(e) applies to the debt instrument.

Example 2. The facts are the same as in *Example 1* of paragraph (b)(3) of this section, except that on June 1, 1995, A sells additional land to B under a contract that calls for B to issue a debt instrument with a stated principal amount of \$100,000. The stated principal amount of this debt instrument (\$100,000) when added to the stated principal amount of the prior debt instrument (\$400,000) does not exceed \$500,000. Thus, section 483(e) applies to both debt instruments.

Example 3. The facts are the same as in *Example 1* of paragraph (b)(3) of this section, except that on June 1, 1995, A sells additional land to B under a contract that calls for B to issue a debt instrument with a stated principal amount of \$150,000. The stated principal amount of this debt instrument when added to the stated principal amount of the prior debt instrument (\$400,000) exceeds \$500,000. Thus, for purposes of section 483(e), the debt instrument issued in the sale of June 1, 1995, is treated as two separate debt instruments: a \$100,000 debt instrument (to which section 483(e) applies) and a \$50,000 debt instrument (to which section 1274, if otherwise applicable, applies).