99TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
99-250

SIMPLIFICATION OF IMPUTED INTEREST RULES

AUGUST 1, 1985.—Ordered to be printed

Mr. ROSTENKOWSKI, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 2475]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2475) to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

TITLE I—AMENDMENTS TO IMPUTED INTEREST RULES

SECTION 101. SIMPLIFICATION OF GENERAL IMPUTED INTEREST RULES.

(a) REDUCTION OF IMPUTATION RATE FROM 120 TO 100 PERCENT; ELIMINATION OF SEPARATE TESTING RATE.—

(1) AMENDMENTS OF SECTION 1274.—

(A) Subparagraph (B) of section 1274(b)(2) of the Internal Revenue Code of 1954 (defining imputed principal amount) is amended by striking out "120 percent of".

(B) Clause (ii) of section 1274(c)(1)(A) of such Code is amended to read as follows:

"(ii) in any other case, the imputed principal amount of such debt instrument determined under subsection (b), and".

(C) Paragraph (2) of section 1274(c) of such Code is amended by striking out "the testing amount" and inserting in lieu thereof "the imputed principal amount of such debt instrument determined under subsection (b)".

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(D) Subsection (c) of section 1274 of such Code is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(2) AMENDMENTS OF SECTION 483.—

(A) The last sentence of section 483(b) of such Code (defining total unstated interest) is amended by striking out "120 percent of".

(B) Subparagraph (B) of section 483(c)(1) of such Code is amended to read as follows:

(B) under which there is total unstated interest."

(b) INTEREST RATES REDETERMINED EACH MONTH.—

(1) IN GENERAL.—Paragraph (1) of section 1274(d) of such Code (defining applicable Federal rate) is amended by striking out subparagraphs (B), (C), and (D) and inserting in lieu thereof the following:

"(B) DETERMINATION OF RATES.—During each calendar month, the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

(C) FEDERAL RATE FOR ANY CALENDAR MONTH.—For purposes of this paragraph—

"(i) FEDERAL SHORT-TERM RATE.—The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.

"(ii) FEDERAL MID-TERM AND LONG-TERM RATES.—The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

"(D) LOWER RATE PERMITTED IN CERTAIN CASES.—The Secretary may by regulations permit a rate to be used with respect to any debt instrument which is lower than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such lower rate is based on the same principles as the applicable Federal rate and is appropriate for the term of such instrument."

(2) RATE APPLICABLE TO ANY SALE OR EXCHANGE.—Paragraph (2) of section 1274(d) of such Code (relating to rate applicable to any sale or exchange) is amended to read as follows:

"(2) LOWEST 3-MONTH RATE APPLICABLE TO ANY SALE OR EXCHANGE.—

"(A) IN GENERAL.—In the case of any sale or exchange, the applicable Federal rate shall be the lowest 3-month rate.

"(B) LOWEST 3-MONTH RATE.—For purposes of subparagraph (A), the term 'lowest 3-month rate' means the lowest of the applicable Federal rates in effect of any month in the 3-calendar-month period ending with the 1st calendar month in which there is a binding contract in writing for such sale or exchange."

(c) RATE INCREASED TO 110 PERCENT IN CASE OF SALE-LEASEBACK.—Section 1274 of such Code (relating to determination of issue price in the case of certain debt instruments issued for property) is amended by adding at the end thereof the following new subsection:

"(e) 110 PERCENT RATE WHERE SALE-LEASEBACK INVOLVED.—

"(1) IN GENERAL.—In the case of any debt instrument to which this subsection applies, the discount rate used under subsection (b)(2)(B) or section 483(b) shall be 110 percent of the applicable Federal rate, compounded semiannually.

"(2) LOWER DISCOUNT RATES SHALL NOT APPLY.—Section 1274A shall not apply to any debt instrument to which this subsection applies.

"(3) DEBT INSTRUMENTS TO WHICH THIS SUBSECTION APPLIES.—This subsection shall apply to any debt instrument given in consideration for the sale or exchange of any property if, pursuant to a plan, the transferor or any related person leases a portion of such property after such sale or exchange."

SEC. 102. LOWER DISCOUNT RATE IN CASE OF CERTAIN SALES WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED $2,800,000.

(a) GENERAL RULE.—Subpart A of part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (relating to original issue discount) is amended by inserting after section 1274 the following new section:

"SEC. 1274A. SPECIAL RULES FOR CERTAIN TRANSACTIONS WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED $2,800,000.

"(a) LOWER DISCOUNT RATE.— In the case of any qualified debt instrument, the discount rate used for purposes of sections 483 and 1274 shall not exceed 9 percent, compounded semiannually.

"(b) QUALIFIED DEBT INSTRUMENT DEFINED.—For purposes of this section, the term 'qualified debt instrument' means any debt instrument given in consideration for the sale or exchange of property (other than new section 38 property within the meaning of section 48(b)) if the stated principal amount of such instrument does not exceed $2,800,000.

"(c) ELECTION TO USE CASH METHOD WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED $2,000,000.—

"(1) IN GENERAL.—In the case of any cash method debt instrument—

"(A) section 1274 shall not apply, and

"(B) interest on such debt instrument shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

"(2) CASH METHOD DEBT INSTRUMENT.—For purposes of paragraph (1), the term 'cash method debt instrument' means any qualified debt instrument if—

"(A) the stated principal amount does not exceed $2,000,000,

"(B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged,

"(C) section 1274 would have applied to such instrument but for an election under this subsection, and

"(D) an election under this subsection is jointly made with respect to such debt instrument by the borrower and lender.

"(3) SUCCESSORS BOUND BY ELECTION.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), paragraph (1) shall apply to any successor to the borrower or lender with respect to a cash method debt instrument.

"(B) EXCEPTION WHERE LENDER TRANSFERS DEBT INSTRUMENT TO ACCRUAL METHOD TAXPAYER.—If the lender (or any successsor) transfers any cash method debt instrument to a taxpayer who uses an accrual method of accounting, this paragraph shall not apply with respect to such instrument for periods after such transfer.

"(4) FAIR MARKET VALUE RULE IN POTENTIALLY ABUSIVE SITUATIONS.—In the case of any cash method debt instrument, section 483 shall be applied as if it included provisions similar to the provisions of section 1274(b)(3).

"(d) OTHER SPECIAL RULES.—

"(1) AGGREGATION RULES.—For purposes of this section—

"(A) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange, and

"(B) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as 1 debt instrument.

"(2) INFLATION ADJUSTMENTS.—

"(A) IN GENERAL.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).

"(B) INFLATION ADJUSTMENT.—For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year exceeds

"(ii) the CPI for calendar year 1988.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

"(1) regulations coordinating the provisions of this section with other provisions of this title,

"(2) regulations necessary to prevent the avoidance of tax through the abuse of the provisions of subsection (c), and

"(3) regulations relating to the treatment of transfers of cash method debt instruments."

(b) Exception for Assumptions.—Subsection (c) of section 1274 of such Code is amended by adding at the end thereof the following new paragraph:

"(4) Exception for assumptions.—If any person—

"(A) in connection with the sale or exchange of property, assumes any debt instrument, or

"(B) acquires any property subject to any debt instrument,

in determining whether this section or section 483 applies to such debt instrument, such assumption (or such acquisition) shall not be taken into account unless the terms and conditions of such debt instrument are modified (or the nature of the transaction is changed) in connection with the assumption (or acquisition)."

(c) Technical Amendments.—

(1) Section 483 of such Code is amended by striking out subsection (e) and by redesignating subsections (f), (g), and (h) as subsections (e), (f), and (g), respectively.

(2) Paragraph (1) of section 483(e) of such Code (as redesignated by paragraph (1)) is amended by striking out "7 percent" and inserting in lieu thereof "6 percent".

(3) Subsection (g) of section 483 of such Code (as redesignated by paragraph (1)) is amended to read as follows:

"(g) Cross References.—

"(1) For treatment of assumptions, see section 1274(c)(4).

"(2) For special rules for certain transactions where stated principal amount does not exceed $2,800,000, see section 1274A.

"(3) For special rules in case of the borrower under certain loans for personal use, see section 1275(b)."

(4) Paragraph (4) of section 280G(d) of such Code is amended by striking out "in accordance with section 1274(b)(2)" and inserting in lieu thereof "by using a discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d)), compounded semiannually".

(d) Clerical Amendment.—The table of sections for subpart A of part V of subchapter P of chapter 1 of such Code is amended by inserting after the item relating to section 1274 the following new item:

"Sec. 1274A. Special rules for certain transactions where stated principal amount does not exceed $2,800,000."

SEC. 103. RECOVERY PERIOD FOR 18-YEAR REAL PROPERTY EXTENDED TO 19 YEARS.

(a) In General.—Clause (i) of section 168(b)(2)(A) of the Internal Revenue Code of 1954 (relating to amount of deduction for 18-year real property) is amended by striking out "18-year recovery period" and inserting in lieu thereof "19-year recovery period".

(b) Technical Amendments.—

(1) The following provisions of the Internal Revenue Code of 1954 are amended by striking out "18-year real property" each place it appears in the text and headings thereof and inserting in lieu thereof "19-year real property":

(A) Section 168 (relating to accelerated cost recovery system).

(B) Section 57(a)(12) (relating to preference for accelerated cost recovery deduction).

(C) Section 312(k)(3)(A) (relating to earnings and profits).

(D) Subparagraphs (A), (B), and (C) of section 1245(a)(5) (relating to gain from dispositions of certain depreciable property).

(2) The table contained in subparagraph (A) of section 168(b)(3) of such Code (relating to election of different recovery percentage) is amended by striking out "18, 35, or 45" and inserting in lieu thereof "19, 35, or 45 years".

(3)(A) Subparagraph (B) of section 168(f)(1) of such Code (relating to components of section 1250 class property) is amended by redesignating clause (iii) as clause (iv) and by inserting after clause (ii) the following new clause:

"(iii) BUILDINGS PLACED IN SERVICE BEFORE MAY 9, 1985.—In the case of any building placed in service by the taxpayer before May 9, 1985, for purposes of applying subparagraph (A) to components of such buildings placed in service after May 8, 1985, the deduction allowable under subsection (a) with respect to such components shall be computed in the same manner as the deduction allowable with respect to the first component placed in service after May 8, 1985."

(B) Clause (ii) of section 168(f)(1)(B) of such Code is amended by striking out "March 15, 1984, the" and inserting in lieu thereof "March 15, 1984, and before May 9, 1985, the".

(C) Clause (iv) of section 168(f)(1)(B) of such Code, as redesignated by subparagraph (A), is amended by striking out "or (ii)" and inserting in lieu thereof ", (ii), or (iii)".

(4) Clause (ii) of section 168(f)(12)(B) of such Code (relating to limitations for property financed with tax-exempt bonds) is amended—

(A) by striking out "15-year real property" each place it appears in the heading and the text and inserting in lieu thereof "19-year real property", and

(B) by striking out "15 years" and inserting in lieu thereof "19 years".

(5) Paragraph (2) of section 48(g) of such Code (relating to special rules for qualified rehabilitated buildings) is amended by striking out "18" in subparagraphs (A)(i) and (B)(v) thereof and inserting in lieu thereof "19".

(6) The table contained in subparagraph (B) of section 47(a)(5) of such Code (relating to special rules for recovery property) is amended by striking out "For 15-year, 10-year, and 5-year property" and inserting in lieu thereof "For property other than 3-year property".

(7) Clause (i) of section 57(a)(12)(B) of such Code (relating to real property and low-income housing) is amended by striking out "18 years" and inserting in lieu thereof "19 years".

SEC. 104. SPECIAL RULE FOR CERTAIN WORKOUTS.

(a) GENERAL RULE.—Sections 483 and 1274 of the Internal Revenue Code of 1954 shall not apply to the issuance or modification of any written indebtedness if—

(1) such issuance or modification is in connection with a workout of a specified MLC loan which (as of May 31, 1985) was substantially in arrears, and

(2) the aggregate principal amount of indebtedness resulting from such workout does not exceed the sum (as of the time of the workout) of the outstanding principal amount of the specified MLC loan and any arrearages on such loan.

(b) SPECIFIED MLC LOAN.—For purposes of subsection (a), the term "specified MLC loan" means any loan which, in a submission dated June 17, 1985, on behalf of the New York State Mortgage Loan Enforcement and Administration Corporation, had one of the following loan numbers: 001, 005, 007, 012, 025, 038, 041, 042, 043, 049, 053, 064, 068, 090, 141, 180, or 188.

SEC. 105. EFFECTIVE DATES.

(a) SECTIONS 101 AND 102.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by sections 101 and 102 shall apply to sales and exchanges after June 30, 1985, in taxable years ending after such date. The amendment made by section 2 of Public Law 98–612 shall not apply to sales and exchanges after June 30, 1985, in taxable years ending after such date.

(2) REGULATORY AUTHORITY TO ESTABLISH LOWER RATE.—Section 1274(d)(1)(D) of the Internal Revenue Code of 1954, as added by section 101(b), shall apply as if included in the amendments made by section 41 of the Tax Reform Act of 1984.

(b) SECTION 103.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by section 103 shall apply with respect to property placed in service by the taxpayer after May 8, 1985.

(2) EXCEPTION.—The amendments made by section 103 shall not apply to property placed in service by the taxpayer before January 1, 1987, if—

(A) the taxpayer or a qualified person entered into a binding contract to purchase or construct such property before May 9, 1985, or

(B) construction of such property was commenced by or for the taxpayer or a qualified person before May 9, 1985.

For purposes of this paragraph, the term "qualified person" means any person whose rights in such a contract or such property are transferred to the taxpayer, but only if such property is not placed in service before such rights are transferred to the taxpayer.

(3) SPECIAL RULE FOR COMPONENTS.—For purposes of applying section 168(f)(1)(B) of the Internal Revenue Code of 1954 (as amended by section 103) to components placed in service after December 31, 1986, property to which paragraph (2) of this subsection applies shall be treated as placed in service by the taxpayer before May 9, 1985.

(4) TECHNICAL CORRECTION.—The amendment made by paragraph (6) of section 103(b) shall apply as if included in the amendments made by section 111 of the Tax Reform Act of 1984.

(5) SPECIAL RULE FOR LEASING OF QUALIFIED REHABILITATED BUILDINGS.—The amendment made by paragraph (5) of section 103(b) to section 48(g)(2)(B)(v) of the Internal Revenue Code of 1954 shall not apply to leases entered into before May 22, 1985, but only if the lessee signed the lease before May 17, 1985.

TITLE II—AMENDMENTS TO BELOW-MARKET INTEREST RULES

SEC. 201. CERTAIN LOANS TO QUALIFIED CONTINUING CARE FACILITIES EXEMPT FROM BELOW-MARKET INTEREST RATE RULES.

(a) IN GENERAL.—Section 7872 of the Internal Revenue Code of 1954 (relating to treatment of loans with below-market interest rates) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) EXCEPTION FOR CERTAIN LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—

"(1) IN GENERAL.—This section shall not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender's spouse) attains age 65 before the close of such year.

"(2) $90,000 LIMIT.—Paragraph (1) shall apply only to the extent that the aggregate outstanding amount of any loan to which such paragraph applies (determined without regard to this paragraph), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility to which paragraph (1) applies, does not exceed $90,000.

"(3) CONTINUING CARE CONTRACT.—For purposes of this section, the term 'continuing care contract' means a written contract between an individual and a qualified continuing care facility under which—

"(A) the individual or individual's spouse may use a qualified continuing care facility for their life or lives,

"(B) the individual or individual's spouse—

"(i) will first—

"(I) reside in a separate, independent living unit with additional facilities outside such unit for the providing of meals and other personal care, and

"(II) not require long-term nursing care, and

"(ii) then will be provided long-term and skilled nursing care as the health of such individual or individual's spouse requires, and

"(C) no additional substantial payment is required if such individual or individual's spouse requires increased personal care services or long-term and skilled nursing care.

"(4) QUALIFIED CONTINUING CARE FACILITY.—

"(A) IN GENERAL.—For purposes of this section, the term 'qualified continuing care facility' means 1 or more facilities—

"(i) which are designed to provide services under continuing care contracts, and

"(ii) substantially all of the residents of which are covered by continuing care contracts.

"(B) SUBSTANTIALLY ALL FACILITIES MUST BE OWNED OR OPERATED BY BORROWER.—A facility shall not be treated as a qualified continuing care facility unless substantially all facilities which are used to provide services which are required to be provided under a continuing care contract are owned or operated by the borrower.

"(C) NURSING HOMES EXCLUDED.—The term 'qualified continuing care facility' shall not include any facility which is of a type which is traditionally considered a nursing home.

"(5) ADJUSTMENT OF LIMIT FOR INFLATION.—

"(A) IN GENERAL.—In the case of any loan made during any calendar year after 1986 to which paragraph (1) applies, the dollar amount in paragraph (2) shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).

"(B) INFLATION ADJUSTMENT.—For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year exceeds

"(ii) the CPI for calendar year 1985.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year."

(b) CLARIFICATION OF APPLICATION OF BELOW-MARKET INTEREST RATE RULES TO LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—Paragraph (1) of section 7872(c) of such Code (relating to below-market loans to which section applies) is amended by adding at the end thereof the following new subparagraph:

"(F) LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—Any loan to any qualified continuing care facility pursuant to a continuing care contract."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 7872(c) of such Code is amended by inserting "and subsection (g)" after "subsection".

(2) Subparagraph (E) of section 7872(c)(1) of such Code is amended by striking out "or (C)" and inserting in lieu thereof "(C), or (F)".

SEC. 202. TIME FOR DETERMINING RATE APPLICABLE TO EMPLOYEE RELOCATION LOANS.

Subsection (f) of section 7872 of the Internal Revenue Code of 1954 (relating to treatment of loans with below-market interest rates) is amended by adding at the end thereof the following new paragraph:

"(11) TIME FOR DETERMINING RATE APPLICABLE TO EMPLOYEE RELOCATION LOANS.—

"(A) IN GENERAL.—In the case of any term loan made by an employer to an employee the proceeds of which are used

by the employee to purchase a principal residence (within the meaning of section 1034), the determination of the applicable Federal rate shall be made as of the date the written contract to purchase such residence was entered into.

"(B) PARAGRAPH ONLY TO APPLY TO CASES TO WHICH SECTION 217 APPLIES.—Subparagraph (A) shall only apply to the purchase of a principal residence in connection with the commencement of work by an employee or a change in the principal place of work of an employee to which section 217 applies."

SEC. 203. SECTION 7872 OF THE INTERNAL REVENUE CODE SHALL NOT APPLY TO NON-LOAN PAYMENTS TO CERTAIN RESIDENTIAL HOUSING FACILITIES FOR THE ELDERLY.

(a) GENERAL RULE.—For purposes of section 7872 of the Internal Revenue Code of 1954, payments made to a specified independent living facility for the elderly by a payor who is an individual at least 65 years old shall not be treated as loans provided—

(1) the independent living facility is designed and operated to meet some substantial combination of the health, physical, emotional, recreational, social, religious and similar needs of persons over the age of 65;

(2) in exchange for the payment, the payor obtains the right to occupy (or equivalent contractual right) independent living quarters located in the independent living facility;

(3) the amount of the payment is equal to the fair market value of the right to occupy the independent living quarters;

(4) upon leaving the independent living facility, the payor is entitled to receive a payment equal to at least 50 percent of the fair market value at that time of the right to occupy the independent living quarters, the timing of which payment may be contingent on the time when the independent living facility is able to locate a new occupant for such quarters; and

(5) the excess, if any, of the fair market value of the independent living quarters at the time the payor leaves such quarters (less a reasonable amount to cover costs) over the amount paid to the payor is used by an organization described in section 501(c)(3) of such Code to provide housing and related services for needy elderly persons.

(b) SPECIFIED INDEPENDENT LIVING FACILITY FOR THE ELDERLY.—For purposes of this section—

(1) IN GENERAL.—The term "specified independent living facility for the elderly" means—

(A) the Our Lady of Life Apartments owned by a Missouri not-for-profit corporation with the same name,

(B) the Laclede Oaks Manor owned by the Lutheran Health Care Association of St. Louis, Missouri, and

(C) the Luther Center Northeast owned by the Lutheran Altenheim Society of Missouri.

(2) REQUIREMENTS.—A facility shall not be considered to be a specified independent living facility for the elderly—

(A) if it is located at any site other than the site which it occupied (or was in the process of occupying through construction) on the date of the enactment of this Act, or

(B) if its ownership is transferred after such date of enactment to a person other than an organization described in section 501(c)(3) of the Internal Revenue Code of 1954.

SEC. 204. EFFECTIVE DATES.

(a) SECTION 201.—

(1) IN GENERAL.—The amendments made by section 201 shall apply with respect to loans made after the date of enactment of this Act.

(2) SECTION 7872 NOT TO APPLY TO CERTAIN LOANS.—Section 7872 of the Internal Revenue Code of 1954 shall not apply to loans made on or before the date of the enactment of this Act to any qualified continuing care facility pursuant to a continuing care contract. For purposes of this paragraph, the terms "qualified continuing care facility" and "continuing care contract" have the meanings given such terms by section 7872(g) of such Code (as added by section 201).

(b) SECTION 202.—The amendment made by section 202 shall apply to contracts entered into after June 30, 1985, in taxable years ending after such date.

(c) SECTION 203.—The provisions of section 203 shall apply as if included in section 172(a) of the Tax Reform Act of 1984.

And the Senate agree to the same.

DAN ROSTENKOWSKI,
SAM M. GIBBONS,
J.J. PICKLE,
CHARLES B. RANGEL,
PETE STARK,
JOHN J. DUNCAN,
BILL ARCHER,
GUY VANDER JAGT,
Managers on the Part of the House.

BOB PACKWOOD,
W.V. ROTH,
JOHN HEINZ,
DAVID DURENBERGER,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
DANIEL PATRICK MOYNIHAN,
Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2475) to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

I. Simplification of General Imputed Interest Rules

A. THE IMPUTED INTEREST RULES

Present law

The imputed interest rate

Overview

Under the imputed interest rules, whether there is adequate stated interest in a debt instrument issued for nonpublicly-traded property is determined by reference to an appropriate "test rate." Where adequate interest is not stated, the imputed interest rules recharacterize a portion of the principal amount of the debt instrument for income tax purposes using a somewhat higher "imputation rate." The amounts of principal and interest as recharacterized will generally determine the seller's "amount realized," the buyer's basis in the property, and the amount of interest deductions and interest income for the buyer and the seller, respectively. The test rate for a debt instrument subject to the imputed interest rules is the rate in effect on the first day there is a binding contract for the sale or exchange of the property. All test and imputation rates are applied using semiannual compounding.

"Test rates" and "imputation rates"

General rule.—For sales or exchanges after December 31, 1984, of new property eligible for the investment credit, and for all sales or exchanges after June 30, 1985, the test rate is 110 percent of the "applicable Federal rate," and the imputation rate is 120 percent of the "applicable Federal rate."

Special rule for certain transactions before July 1, 1985.—For sales or exchanges after December 31, 1984, and before July 1, 1985, of property other than new property eligible for the investment credit, the test rate for "borrowed amounts" not exceeding $2 million is 9 percent. The test rate for borrowed amounts exceeding $2 million is a "blend" of 9 percent on the first $2 million and 110 percent of the applicable Federal rate (the "AFR") on the excess. In applying the $2 million limitation, all sales or exchanges that are part of the same transaction (or a series of related transactions) are treated as one transaction, and all debt instruments arising from the same transaction (or a series of related transactions) are treated as one debt instrument. The imputation rate for transactions during this same period is 10 percent for borrowed amounts up to $2 million and a blend of 10 percent and 120 percent of the AFR for borrowed amounts exceeding $2 million.

Other lower test and imputation rates.—The test rate for certain sales of homes and farm property after June 30, 1985, may not exceed 9 percent. This exception generally is limited to $250,000 for sales of homes and $1 million for sales of farms.

Applicable Federal rate.—The applicable Federal rate ("AFR") for a debt instrument is the lower of two published rates, one specified by the Tax Reform Act of 1984 (the "1984 Act") and one specified in temporary Treasury regulations. The statutory rate is based on the weighted average of yields over a period of six months for marketable obligations of the United States Government with a comparable maturity. Such rates are redetermined at six-month intervals for three categories of debt instruments: short-term maturity (three years or less), mid-term maturity (more than three years but not in excess of nine years), and long-term maturity (more than nine years).[1]

The rates determined under the temporary Treasury regulations are intended to reflect more accurately the current marketplace.[2] These rates are computed monthly using the same methodology described above, except that the rates reflect the average yields for one-month periods. In any month, the lower of the six-month rate or the monthly rate is the AFR. However, in cases where the monthly rate for either of the two preceding months is lower than the AFR for a particular month, the test rate for that month is the lower of the two such rates.

Exceptions.—The imputed interest rules do not apply to the obligor on a debt instrument incurred in the acquisition of personal use property, to the sale of certain patents, to certain annuities, and to transactions involving a sale of property with a sales price of not more than $3,000.

[1] Appropriate adjustments to the rates are to be made for application to debt instruments, the interest on which is wholly or partly exempt from tax (sec. 1288).

[2] The mechanism provided by the temporary regulations is intended to respond to a problem that may exist where interest rates decline after the period in which the Federal rates were determined.

Method of accounting

Interest income and expense on debt instruments that are issued for property and that do not require the current payment of interest generally must be accounted for on the accrual method of accounting unless one of the following exceptions apply.

The accrual accounting requirement does not apply to (1) debt instruments issued for nonpublicly-traded property in transactions that are excepted from the imputed interest rules, (2) debt created in the sale of certain small businesses and farms, (3) debt created in the sale of a principal residence, and (4) debt created where the total payments are less than $250,000.

Assumptions

The assumption of the following debt obligations in connection with the sale or exchange of property, or the taking of property subject to such debt obligations, does not result in the application of the imputed interest rules, provided that the terms and conditions of the obligation are not modified in connection with the sale: (1) loans that were made before October 16, 1984, and assumed after December 31, 1984, in connection with the sale of property the purchase price of which does not exceed $100 million and (2) all loans assumed in connection with the sale of a residence, certain farms, and certain trades or businesses.

House Bill

The imputed interest rules

Overview

The House bill makes four basic changes to the imputed interest rates. First, the House bill generally reduces the test rate from 110 percent of the AFR to 100 percent of the AFR. Second, the House bill provides for lower imputed interest rates for certain smaller transactions. Third, the House bill provides that the imputation rate would be the same as the test rate (i.e., there would be no higher "penalty rate" where inadequate interest is stated). Finally, the House bill revises the computation of the AFR from a semiannual rate to a monthly rate.

Lower overall imputed interest rate

Under the House bill, the imputed interest rate (i.e., the test rate and the imputation rate) is reduced to 100 percent of the AFR.

Lower imputed interest rates for certain smaller transactions

The House bill places a limit on the imputed interest rates in smaller transactions that do not involve new property eligible for the investment tax credit. Under these rules, where the amount of seller financing [3] does not exceed $2 million, the House bill provides that the imputed interest rate cannot exceed 9 percent.[4]

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[3] The amount of seller financing is measured by the stated principal amount of the seller-financed debt instrument.

[4] As under present law, all rates will be compounded semiannually.

Where the amount of seller financing exceeds $2 million but is less than $4 million, the imputed interest rate cannot exceed a "blend" of 9 percent on a specified portion of the seller financing and the 100 percent of the AFR on the remainder. The portion of the seller-financing eligible for the 9 percent rate is equal to $2 million reduced dollar-for-dollar by the amount of seller financng over $2 million. Where the amount of seller financing is $4 million or more, the imputed interest rate is equal to 100 percent of the AFR. The $2 million and $4 million thresholds amounts will be indexed for inflation beginning after 1988.

For sales of new property eligible for the investment credit, the imputed interest rate for a seller-financed debt instrument is equal to 100 percent of the AFR regardless of the amount of seller financing.

Elimination of the penalty rate

Under the House bill, the imputation rate for a debt instrument that fails to state adequate interest will be the same as the test rate for that instrument. Accordingly, there is only one "imputed interest rate" for a transaction and there is no separate "penalty rate" where a debt instrument does not state adequate interest for any reason.

Determination of the applicable Federal rate

Under the House bill, the sole mechanism for determining the AFR will be the one currently prescribed by the temporary Treasury regulations. The alternative mechanism under present law for determining the six-month rate prescribed by the 1984 Act will be eliminated.

Under these revised rules, the AFR will be computed using the same methodology as under present law, except that the rates will be determined on a monthly basis and the rate will reflect the average yields for one-month periods. In addition, the AFR for a particular month may be used as the imputed interest rate for contracts for sales or exchanges entered into in that month and the next two succeeding months.

Regulatory authority

The House bill authorizes the Treasury Department to issue regulations specifying the circumstances in which transactions will be treated as "part of the same transaction or related transactions" for the purpose of applying the $2 million and $4 million limitations. The House bill also provides that the Treasury Department is authorized to issue regulations under which taxpayers would be permitted to demonstrate that, in appropriate circumstances, a rate lower than the AFR provided by the statute, but calculated according to the same principles as the AFR,[5] is a more appropriate imputed interest rate for a particular debt instrument. Finally, the House bill authorizes the Treasury Department to issue regulations regarding the relationship of the imputed interest provisions to other Code provisions.

[5] That is, a rate that is calculated by reference to Treasury obligations with similar maturity.

Method of accounting

The House bill provides that, in the case of certain debt instruments that otherwise would be subject to the accrual accounting requirement, interest income and expense arising from such debt instruments may be accounted for on the cash receipts and disbursements method of accounting. To be eligible for such treatment, (1) the stated principal amount of the debt instrument cannot exceed $2 million, (2) the debt instrument must arise from the sale of property by a cash-basis taxpayer who is not a dealer in the type of property sold, and (3) the lender and the borrower must jointly elect such treatment. A debt instrument meeting these requirements is to be known as a "cash-method debt instrument."

Special rules are provided relating to the treatment of taxpayers who are the successors to either the issuer or holder of a cash-method debt instrument. The Treasury Department is authorized to issue regulations prescribing rules to prevent abuses of the special treatment afforded to cash-method debt instruments.

Assumptions

Under the House bill, if an existing debt instrument is assumed in connection with the sale or exchange of property (or if the property is acquired subject to an existing debt instrument), the imputed interest rules will not apply to such existing debt instrument by reason of such assumption (or aquisition) unless either the terms of the existing debt instrument are modified in connection with the transaction or the nature of the transaction is changed.

Effective date

The provisions of the House bill relating to the amendment of the imputed interest rules are effective for sales or exchanges occurring after June 30, 1985.

Senate amendment

The imputed interest rules

The Senate amendment generally follows the House bill with certain modifications. Under the Senate amendment, in general, the amount of seller financing that would be eligible for the 9 percent rate is $2 million for all transactions where the amount of seller financing does not exceed $4 million. In transactions involving the sale of farm property or real property used in certain closely held trades or businesses, $2 million of seller financing would be eligible for the 9 percent rate, provided the total amount of seller financing did not exceed $9 million. Also under the Senate amendment, an imputed interest rate of 110 percent of the AFR would apply to any sale-leaseback transaction or any transaction involving a sales price in excess of $25 million. In addition, where the AFR exceeded 12 percent, the imputed interest rate for certain transactions would be limited to the sum of 12 percent and one-third of the excess of the AFR over 12 percent.

The authority granted to the Treasury Department to provide regulations that would permit taxpayers to prove that a lower imputed interest rate is appropriate would be effective as if it were contained in the 1984 Act.

Method of accounting

The Senate amendment is the same as the House bill.

Assumptions

The Senate amendment is the same as the House bill.

Conference agreement

The imputed interest rules

The conference agreement generally follows the House bill with the following modifications. Under the conference agreement, where the amount of seller financing does not exceed $2,800,000, the imputed interest rate generally may not exceed 9 percent. Where the amount of seller financing is greater than $2,800,000, the imputed interest rate is generally 100 percent of the AFR. An imputed interest rate of 110 percent of the AFR, however, applies to sale-leaseback transactions. Indexing of the $2,800,000 threshold for the 9 percent rate (and the $2 million threshold for cash-method debt instruments) begins after 1989.

The effective date of the regulatory authority relating to the use of a lower imputed interest rate is the same as in the Senate amendment. In this regard, the conferees intend that the regulatory authority be exercised in a manner so that the lower rate would be permitted only in circumstances where it can be demonstrated that both the rate recalculated based on the same principles as the AFR and the rate at which the borrower can borrow funds on an arm's length basis is lower than the AFR that otherwise would be applicable to the borrower's debt instrument. Further, it is intended that the rate permitted under the regulations would be not less than the borrower's arm's length borrowing rate.

The conferees understand that where a sale or exchange takes place after June 30, 1985, pursuant to a binding contract entered into on or before that date, the imputed interest rates for such a transaction are to be determined pursuant to the provisions of the conference agreement using the applicable Federal rates in effect on the date the binding contract was entered into. For example, if a seller executes a binding contract on March 15, 1985, with a buyer to purchase nonpublicly-traded property with seller financing of $3 million and the transaction is closed on July 15, 1985, the test rate is 100 percent of the AFR for March 15, 1985.

Under the conference agreement, the imputed interest rules will not be applied to the issuance or modification of certain specified debt instruments held by the New York State Mortgage Loan Enforcement and Administration Corporation provided such issuance or modification is in connection with the workout of such debt instruments and the principal amount of indebtedness resulting from such workout does not exceed the sum (as of the time of the workout) of the outstanding principal amount of the specified debt instrument and any arrearages thereon. The conferees understand that the rate of interest charged with respect to the arrearages shall be not less than the rate on the related loan. The conferees intend no inference in adopting this provision regarding the appropriate income tax treatment of such debt instruments or of other debt instruments in similar circumstances. Specifically, the conferees intend that no inferences be taken from the adoption of this provision that any arrangements existing prior to or resulting from these workout agreements is properly considered as debt for tax purposes.

Method of accounting

The conference agreement is the same as the House bill and the Senate amendment.

Assumptions

The conference agreement is the same as the House bill and the Senate amendment. The conferees are concerned about the extent to which the assumption rules apply when the terms of the debt are modified. The conferees expect that the Treasury Department will issue regulations, consistent with the purposes of these provisions, regarding the proper tax treatment of all parties in transactions where the terms and conditions of the obligation are modified or changed in connection with the transfer of property.

B. ACCELERATED COST RECOVERY SYSTEM

Present law

In general, domestic real property placed in service after March 15, 1984, and qualifying as recovery property, may be depreciated on an accelerated basis under ACRS over an 18-year period, under tables of recovery percentages prescribed by the Treasury Department. These tables reflect a "mid-month" convention for property placed in service after June 22, 1984. Taxpayers may also elect to depreciate such property on a straight-line basis over 18, 35, or 45 years. The recovery period under ACRS for low-income housing described in sections 1250(a)(1)(B) (i), (ii), (iii) or (iv) is 15 years and no mid-month convention is used.

Under transitional rules provided by the 1984 Act, property placed in service after March 15, 1984, pursuant to binding contracts entered into, or where construction was commenced by or for the taxpayer, prior to March 16, 1984, may be eligible for a 15-year recovery period. Special rules under the 1984 Act are also provided relating to components of real property placed in service prior to March 16, 1984, that are placed in service on or after that date.[6]

House bill

Under the House bill, the minimum recovery period for domestic real property qualifying as recovery property generally is increased from 18 years to 19 years. However, this change in the recovery period does not affect the ACRS provisions relating to low-income housing (the recovery period of which remains at 15 years).

The provision of the House bill relating to the ACRS recovery period for real property is generally effective for property placed in

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[6] Sec. 168(f)(1).

service after May 8, 1985. Transitional rules similar to those under the 1984 Act are provided for property that is placed in service after May 8, 1985, and before January 1, 1987, where there was a binding contract to construct or acquire the property, or where construction was begun by or for the taxpayer before May 9, 1985. Special rules apply to components placed in service after May 8, 1985.[7]

Senate amendment

The Senate amendment is the same as the House bill with the exception that a conforming amendment relating to the eligibility of lessee-incurred costs for the rehabilitation tax credit (secs. 46 and 48(g)) is not effective for leases executed prior to May 22, 1985, if the lessee signed the lease before May 17, 1985.

Conference agreement

The conference agreement is the same as the Senate amendment. The conferees intent that the recovery percentages to be computed by the Treasury Department be done on a more exact basis than is current practice. Specifically, if the Treasury Department provides that depreciation may be calculated by applying specified percentages to the basis of the property, the conferees intend that the percentage be expressed to at least the nearest tenth of a percentage point. Similarly, separate percentage rates should be provided for each month during a taxable year during which the property may be placed in service.

II. Below-Market Loan Provisions

Present law

Section 7872 of the Code, added by the 1984 Act, generally provides that certain loans that bear interest at a below-market rate, are to be treated as loans bearing interest at the market rate accompanied by a payment or payments from the lender to the borrower which are characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.). The market rate of interest for purposes of section 7872 is assumed to be 100 percent of the AFR at the time the loan is made in the case of a term loan or, in the case of a demand loan, 100 percent of the AFR in effect over the time that the loan is outstanding. The monthly rate provided by the temporary Treasury regulations under the imputed interest rules does not apply for this purpose.

Section 7872 applies to (1) loans where the foregone (i.e., below-market) interest is in the nature of a gift, (2) loans to an employee from an employer or to an independent contractor from one for whom the independent contractor provides services, (3) loans between a corporation and a shareholder of the corporation, (4) loans of which one of the principal purposes of the interest arrangement is the avoidance of any Federal tax, and (5) to the extent provided in Treasury regulations, any below-market loan if the interest arrangement of such loan has a significant effect on any Federal tax

[7] Sec. 168(f)(1).

liability of either the lender or borrower. The provisions of section 7872 generally apply to term loans made after June 6, 1984, and to demand loans made after that date (or demand loans outstanding after June 6, 1984, which are not repaid before September 17, 1984). However, the below market loan rules do not apply to loans made to elderly care facilities before June 6, 1984, that are contingent on the continued residence of the lender at the facility. The application of section 7872 is limited by certain *de minimis* exceptions and, for certain gift loans, by the net investment income of the borrower. In addition, transactions covered by the last category above (i.e., number 5) would not be effective prior to the issuance of such Treasury regulations.

Below-market loans made by individuals pursuant to arrangements providing for the satisfaction of personal needs in retirement may be considered to come within either of the last two categories.

House bill

No provision.

Senate amendment

Loans to continuing care facilities

Overview

Under the Senate amendment, certain below-market loans to a "continuing care facility," made pursuant to a "continuing care contract" are excepted from the below-market loan provisions of the Code. Thus, under the Senate amendment, such loans will not be treated as bearing an interest rate equal to the applicable Federal rate and no additional payments will be treated as made from the lender to the borrower. Loans to continuing care facilities pursuant to continuing care contracts would be subject to the below-market loan provisions to the extent that the criteria for the exception are not met.

Continuing care contract

A continuing care contract is an arrangement between an individual or a married couple and a continuing care facility that meets five requirements. Under the first requirement, a retired individual or couple must be entitled to the use of the continuing care facility for the remainder of the individual's life or both married spouses' lives. Under the second requirement, such use must commence with residence in a separate, independent living unit provided by the continuing care facility.

Under the third requirement, during the period in which the individuals reside in the independent living units, the continuing care facility must be obliged to provide such individuals with various "personal care" services. Under the fourth requirement, the continuing care facility must also undertake to provide long-term nursing care for those individuals who are no longer capable of living independently, even with the aid of personal care services. Under the fifth requirement, the continuing care contract must require the continuing care facility to provide the personal care and long-term nursing services without substantial additional cost to the individual (i.e., there must be a significant insurance-like element for the individual).

Continuing care facility

A continuing care facility is one or more facilities that are designed to provide services under continuing care contracts and substantially all of the residents of which have entered into continuing care contracts.

Limitations

The exception is available for a loan only as of the calendar year in which the lender has attained age 65. A loan from either or both members of a married couple where only one spouse has attained age 65 will be treated as qualifying for the exception if both of the spouses are to reside in the continuing care facility. The exception applies only to the extent that the principal amount of a loan, when added to the aggregate outstanding amount of all other previous loans between the lender (or if the lender is married, the lender and the lender's spouse) to any continuing care facility, does not exceed $90,000. This amount is indexed for inflation.

Special rule for certain payments

Payment arrangements meeting specified requirements, between an individual and an elderly care facility meeting specified requirements are not treated as loans for purposes of the below-market loan rules. In general, the payment arrangement is one where an initial payment and a portion thereof that is refundable is based on the fair market value of residential accommodations supplied to the individual by the elderly care facility.

Effective date

The provisions of the Senate amendment relating to below-market loans to continuing care facilities pursuant to continuing care contracts are generally effective with respect to such loans that are made after the date of enactment. All such loans made on or before the date of enactment are excepted from the below-market loan rules. In addition, any Treasury regulations relating to the application of the below-market loan rules to loans made to any elderly care facilities are prohibited from taking effect prior to January 1, 1986.

Employee relocation loans

The Senate amendment modifies the below-market loan rules with respect to so-called "employee relocation loans." An employee relocation loan is a loan from an employer to an employee, the proceeds of which are used by the employee toward the purchase of a principal residence in connection with commencement of work by the employee at a new principal place of work. The purchase of the principal residence must occur in a situation where any moving expenses incurred by the employee would be deductible under section 217 of the Code.

In the case of such employee relocation loans, the rate used for determining whether the loan is a below-market loan to which additional interest will be imputed, is the AFR for the month in which the employee enters into a written contract for the purchase of the principal residence, rather than the month in which the loan is made.

The provisions of the Senate amendment relating to employee relocation loans are effective for loans made pursuant to purchase contracts entered into after June 30, 1985.

Conference agreement

Loans to continuing care facilities

The conference agreement generally follows the Senate amendment with certain modifications. First, the requirement that the continuing care facility own or operate substantially all the facilities used to provide services under a continuing care contract is effective without regard to when a facility began operating (or a contract for the construction of the facility was entered into). Second, no restrictions are placed on the effective date of any Treasury regulations relating to the application of the below-market loan rules to loans made to elderly care facilities.

The provision in the Senate amendment relating to whether specified payment arrangements are to be treated as loans for purposes of the below-market loan rules is limited to three specified elderly care facilities that would not qualify as continuing care facilities under the Senate amendment. In this regard, the conferees confirm that the below-market loan rules of the 1984 Act and the changes made to those rules by this bill only apply to transactions that are loans for Federal income tax purposes. The conferees specifically intend that the provisions of the bill do not define, and do not alter, the prior law rules relating to what transactions are, or are not, to be treated as loans. In addition, the conferees understand that a payment to a continuing care facility pursuant to a continuing care contract frequently is wholly or partially refundable for a relatively brief period (e.g., six months) essentially for consumer protection purposes pursuant to State law or regulations. The conferees also understand that payments to a continuing care facility are often refundable on a declining pro rata basis over a somewhat longer period (often up to eight years). The conferees understand that such payments ordinarily would be treated as the advance payment of fees and not as loans under present law.

In addition, certain technical modifications have been made to the language contained in the Senate amendment.

Employee relocation loans

The conference agreement follows the Senate amendment.

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