APPENDIX—REGULATORY REVIEW MODIFIED REVOLVING TEN-YEAR SCHEDULE—Continued

16 CFR Part	Topic	Year to review	Office to review
24	Leather Products Guides	2006	DARO.

[FR Doc. 96–33017 Filed 12–26–96; 8:45 am]

BILLING CODE 6750–01–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1 and 5

Revised Procedures for Commission Review and Approval of Applications for Contract Market Designation and of Exchange Rules Relating to Contracts Terms and Conditions

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rulemaking.

SUMMARY: On November 22, 1996, the Commodity Futures Trading Commission (Commission) published in the Federal Register a proposal to amend its procedures relating to its review and approval of applications for contract market designation and proposed exchange rules relating to contract terms and conditions (61 FR 59386). The comment period ends on December 23, 1996. These fast-track review procedures are intended further to streamline Commission review of applications for contract market designation and proposed exchange rule amendments relating to contract terms and conditions. The Commission has determined, in this instance, to extend the comment period.

DATES: Comments must be received on or before January 16, 1997.

ADDRESSES: Comments should be mailed to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581, attention: Office of the Secretariat; transmitted by facsimile at (202) 418–5521; or transmitted electronically at [secretary@cftc.gov]. Reference should be made to ''Fast-track Designation and Rule Approval Procedures.''

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581, (202) 418–5260, or electronically, [PArchitzel@cftc.gov].

SUPPLEMENTARY INFORMATION: The New York Mercantile Exchange (NYMEX) has filed a petition requesting an extension of time to submit comments on the Commission's proposed rulemaking concerning approval of applications for contract market designation and of exchange rules relating to contract terms and conditions. The Exchange requests an extension until January 16, 1997—the date that comments are to be received on the proposed rulemaking concerning the related topic of contract market review procedures for other rules (61 FR 66241, December 17, 1996). The NYMEX stated that it has spoken to representatives from the Chicago Mercantile Exchange and the Chicago Board of Trade concerning this request for an extension and that those exchanges agreed to join this request.

The Exchange stated that, since the proposed rulemakings concern similar and related issues, the issues should be considered and evaluated together and can best be addressed in one comment letter. Accordingly, the NYMEX concluded that a short delay will result in a more efficient rulemaking process.

For the reasons noted above, the Commission has determined to extend the public comment period for the subject rulemaking. The Commission believes that an extension of the comment period until January 16, 1997, would permit the NYMEX and any other interested parties fully to evaluate the proposed rulemaking and to submit their comments thereon to the Commission. The Commission cautions that the deadline for comments on the subject proposed rulemaking is independent of the deadline for comments on the proposed rulemaking concerning contract market review procedures for other rules. Any request for and Commission action on an extension of the comment period for the latter proposed rulemaking will not affect the deadline for comments on the subject proposed rulemaking.

Issued in Washington, DC on December 20, 1996.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 96–33072 Filed 12–26–96; 8:45 am]

BILLING CODE 6351–01–M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–209817–96]

RIN 1545–AU19

Treatment of Obligation-Shifting Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the treatment of certain multiple-party financing transactions in which one party realizes income from leases or similar agreements and another party claims deductions related to that income. In order to prevent tax avoidance, the proposed regulations recharacterize these transactions in a manner that clearly reflects income. The proposed regulations affect only persons that engage in these transactions. The regulations generally do not apply to routine transactions lacking characteristics of tax avoidance. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written comments, requests to appear, and outlines of topics to be discussed at the public hearing scheduled for April 29, 1997, at 10 a.m. must be received by April 8, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209817–96), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209817–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax__regs/comments.html. The public hearing will be held in the IRS Auditorium, Internal Revenue Building,

7th Floor, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jonathan Zelnik at (202) 622–3940; concerning submissions and the hearing, Christina Vasquez at (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by April 8, 1997. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the collection will have a practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information is in § 1.7701(l)–2(j). This information is required by the IRS to verify pass-through entity compliance with § 1.7701(l)–2. This information will be used to determine whether the amount of tax has been computed correctly. The collection of information is mandatory. The likely recordkeepers are businesses and other organizations. Estimated total annual recordkeeping burden: 500 hours. Estimated average annual burden per recordkeeper: 5 hours. Estimated number of recordkeepers: 100.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

Background

The IRS and Treasury Department have become aware of multiple-party financing transactions (''stripping transactions'') intended to allow one party to realize income from a lease or similar agreement and to allow another party to report deductions related to that income (for example, cost recovery or rental expenses). Notice 95–53, 1995–2 C.B. 334, describes several examples of these transactions, including transferred basis transactions, transfers of partnership interests, and variations involving licenses, service contracts, and prepayment, front-loading, and retention of rights to receive future payments.

Notice 95–53 states the position of the IRS that the claimed tax treatment of these transactions improperly separates income from related deductions and that the transactions do not produce the tax consequences desired by the parties. The notice also states that regulations will be issued under section 7701(l) of the Internal Revenue Code recharacterizing stripping transactions any significant element of which is entered into or undertaken on or after October 13, 1995. The notice requested comments regarding those regulations.

The IRS received only one set of comments in response to Notice 95–53. Those comments recommended that the regulations under section 7701(l) address a broader class of transactions than was described in the notice. Specifically, they recommended that the regulations defer the recognition of income in circumstances where there is an advance receipt or assignment of future income and there is the potential for the transactions to become stripping transactions. They also recommended that the regulations recharacterize these transactions without regard to whether there is a tax avoidance purpose. The comments reflected a desire for the regulations to produce an economic accrual of income and to enable taxpayers to determine the proper tax accounting for their transactions without regard to subsequent events.

The proposed regulations generally follow the notice and do not expand the class of transactions subject to recharacterization. The regulations do not require taxpayers to make any assumptions as to subsequent events. They are intended to produce tax results that conform to the economic substance of the transactions that they address. Furthermore, the regulations generally apply to transactions whether or not the parties have a tax avoidance purpose.

Explanation of Provisions

1. General Approach

Section 7701(l) authorizes the Secretary to ''prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by [the Internal Revenue Code].'' The proposed regulations recharacterize transactions in which the transferee (''the assuming party'') assumes obligations or acquires property subject to obligations under an existing lease or similar agreement and the transferor (''the property provider'') or any other party has already received or retains the right to receive amounts that are allocable to periods after the transfer. The recharacterization reflects the general principle that a taxpayer who is treated for federal income tax purposes as the owner of rental property must recognize income that accrues during its period of ownership. , *e.g.*, *Steinway & Sons* v. *Commissioner,* 46 T.C. 375 (1966), *acq.,* 1967–2 C.B. 3; *Alstores Realty Corp.* v. *Commissioner,* 46 T.C. 363 (1966), *acq.,* 1967–2 C.B. 1.

For the period in which an assuming party in such a transaction is a party to the lease or similar agreement, the recharacterization requires the assuming party to report income on a level-rent basis calculated using the rules of the constant rental accrual method described in § 1.467–3(d) as proposed on June 3, 1996 (IA–292–84, 61 FR 27834, 27844). Thus, the assuming party is required to recognize rental income for the period in which it owns the property or leasehold interest. In addition, the transaction is recharacterized to include additional consideration in the form of a note provided by the assuming party to the property provider for the transfer of the property, resulting in interest income and expense for which the parties must account as appropriate. The property provider also must adjust its income for any differences between amounts it recognized and amounts it would have recognized if it had reported income on a level-rent basis for the periods that it owned the property or leasehold

interest. Finally, to account for any differences in timing or amount between payments the property provider actually receives after the transaction and payments treated as being made to the property provider under the note from the assuming party, the property provider is treated as an obligor or obligee under a second loan, for which the property provider must account accordingly.

2. Obligation-shifting Tsransactions

The proposed regulations are not intended to recharacterize transactions with little potential for tax avoidance. Taken together, the definition of ''obligation-shifting transaction'' and the enumerated exceptions limit the scope of the regulations to transactions that are not routine and that involve shifting of substantial amounts of income away from the taxpayer that recognizes deductions related to the income.

The proposed regulations apply to obligation-shifting transactions, which are defined as any transaction in which an assuming party assumes a property provider's obligations to a property user (or acquires property subject to a property provider's obligations to a property user) under a lease or similar agreement if the property provider or any other party has already received, or retains the right to receive, amounts that are allocable to periods after the transaction. The regulations define obligations under a lease or similar agreement as including a continuing obligation to make property available to the lessee or the ultimate user of the property. These obligations typically give rise to deductions, such as for cost recovery or, in the case of a master-lease/sublease arrangement, for payments under a master lease. The advance receipt of amounts that are allocable to periods after the obligation-shifting transaction often results in accelerated taxable income for the recipient. Thus, the definition describes transactions in which there is the potential for one party to recognize income but a different party to recognize deductions associated with that income.

In some transactions identified in Notice 95–53, one party sells, assigns, or otherwise transfers to a third party the right to receive future payments under a lease and includes as current income the amount received as consideration for the transfer. The underlying property (subject to the lease) is later transferred in a transaction intended to qualify as a transferred basis transaction. These transactions are within the scope of the regulations because the property transferee assumes obligations or acquires the property subject to the obligation to make the property available to the lessee and the property transferor already received amounts that are allocable to periods after the transaction by reason of the assignment of rights to receive future payments. In other transactions, the property transferor does not assign the right to future rental amounts but instead receives prepayment from the lessee or retains the right to receive future amounts over time. Both variations likewise are within the scope of the regulations.

The proposed regulations adopt an aggregate view of partnerships, treating each partner as having a proportionate share of the rights and obligations of the partnership. Thus, for example, if a partnership assigns its right to receive future amounts under a lease and allocates to its current partners the amount recognized, a later transfer of a partnership interest is an obligation-shifting transaction because the transferee partner assumes an allocable share of the partnership's obligation to make the property available to the lessee and because the transferor partner is treated as having already received amounts that are allocable to periods after the transaction. See *Example 3* of the proposed regulations. In appropriate cases, the IRS may assert other authorities to prevent the use of a partnership to effect an improper separation of income from related deductions. *See, e.g.,* § 1.701–2(d) (*Example 7*).

The proposed regulations also generally treat an obligation-shifting transaction as occurring if a subsidiary that is a member of a consolidated group becomes a nonmember at a time when the subsidiary has received payments under a lease or similar agreement that are allocable to periods after the transaction.

3. Lease or Similar Agreement

Under the proposed regulations, an obligation-shifting transaction involves a lease or similar agreement. The regulations define this term broadly to include any contract for the use or enjoyment of tangible or intangible property, including leaseholds, licenses, other non-fee interests in property, and other contracts (including service contracts) involving the use or enjoyment of property if the value of that use or enjoyment is more than *de minimis.* The proposed regulations, therefore, do not apply to service contracts that do not involve the use or enjoyment of property. The definition of obligation-shifting transaction, however, does not restrict the IRS's ability to challenge these transactions under other authorities. For instance, even if a transaction is not within the scope of the proposed regulation, the IRS may challenge it under one or more of the authorities identified in Notice 95–53.

The IRS requests comments on whether additional guidance is needed on the definition of lease or similar agreement.

4. Exceptions

The proposed regulations are not intended to recharacterize otherwise routine transactions, such as the incorporation of an entire line of business that does not involve significant shifting of income and deductions. See Rev. Rul. 80–198, 1980–2 C.B. 113, subject to the limitations described therein. Accordingly, the regulations provide a number of objective exceptions that generally will protect routine transactions from recharacterization. The regulations do not apply to transactions in which the amounts that are allocable to future periods but are not transferred are less than or equal to $100,000. The regulations do not apply to transactions in which total payments (including the aggregate expected future value of all contingent consideration) under the lease or similar agreement are not reasonably expected to exceed $250,000. The regulations do not apply to transactions in which the fair market value of the property that is subject to the lease or similar agreement and is transferred in the obligation-shifting transaction, plus the value of the amounts that are already received or retained by the property provider but are allocable to periods after the obligation-shifting transaction, is less than ten percent of the total assets (other than Class I and Class II assets as described in § 1.1060–1T(d) and debt issued by the property provider) transferred by the property provider in the transaction. The regulations do not apply to transactions in which the lease or similar agreement is a disqualified leaseback or long-term agreement within the meaning of § 1.467–3(b). The regulations do not apply to transactions described in section 381(a), unless the transaction is deemed to be an obligation-shifting transaction under proposed § 1.7701(l)–2(k). Finally, the regulations provide that a transaction is exempt from recharacterization if the parties to the transaction establish to the satisfaction of the Commissioner that the transaction does not present a significant potential for tax avoidance.

Because the purpose of recharacterization under section 7701(l) is to prevent tax avoidance, these objective exceptions are unavailable for

transactions entered into with a principal purpose of substantially reducing the present value of the aggregate tax liability of the property provider, the assuming party, and any other party whose taxable income is determined by reference to the taxable income of the property provider or the assuming party.

5. Recharacterization

The proposed regulations recharacterize an obligation- shifting transaction in order to ensure that the property provider and the assuming party both report the income from the underlying property allocable to their respective periods of ownership.

For purposes of determining the amounts that are allocable to periods under the lease or similar agreement, the proposed regulations apply a rent-leveling process based on the constant rental accrual method described in § 1.467–3(d) to all amounts that are treated as payable under the lease or similar agreement. At the time of the obligation-shifting transaction, the level rental amount is determined for the entire term of the lease or similar agreement using 110 percent of the applicable Federal rate based on that term. The amounts that are treated as payable under the lease or similar agreement at the time of the obligation-shifting transaction are the amounts that have already been paid to the property provider and the future amounts that, immediately before the obligation-shifting transaction, are payable to the property provider. Thus, if the property provider assigns the right to receive payments to a third party in exchange for consideration, the consideration is treated as an amount received under the lease or similar agreement. Because the property provider no longer has the right to receive the payments assigned to the third party, those payments (whether past or future) are not treated as amounts that are payable to the property provider for purposes of calculating the level rental amount.

The proposed regulations recharacterize an obligation- shifting transaction by treating the assuming party and the property provider as follows:

The assuming party is treated as acquiring the right to receive all amounts that are allocable to periods after the obligation-shifting transaction. The assuming party includes these amounts in income for the periods that it owns the property.

To reflect the amounts that the assuming party is treated as receiving under the recharacterization but that it does not actually receive, the assuming party also is treated as providing additional consideration to the property provider in the form of a note (a ''section 7701(l) note''). The original principal balance of the section 7701(l) note equals the excess of the present value of the amounts that are allocable to periods after the obligation-shifting transaction over the present value of the amounts that are payable to the assuming party.

The property provider must adjust its income to the extent that it accounted for income under the lease or similar agreement before the obligation-shifting transaction in a manner inconsistent with the level-rent method described above. The adjustment, which can increase or decrease the property provider's income, equals the principal balance of the section 467 loan that would have existed if the property provider had been using the constant rental accrual method to account for amounts under the lease or similar agreement that are allocable to periods before the obligation-shifting transaction, reduced by any existing section 467 loan if the lease or similar agreement is a section 467 rental agreement. The constant rental amount is calculated using the amounts that are treated as payable under the lease or similar agreement.

Finally, to account for any differences in timing or amount between payments the property provider actually receives after the obligation-shifting transaction and payments treated as being made to the property provider under the section 7701(l) note, the property provider is treated as a party to a loan (a ''section 7701(l) rent-leveling loan''). The section 7701(l) rent-leveling loan is created at the time of the obligation-shifting transaction. Its balance at that time equals the section 467 loan that would have existed if the property provider had been using the constant rental accrual method to account for amounts under the lease or similar agreement that are allocable to periods before the obligation-shifting transaction. Thus, in the periods after the obligation-shifting transaction, the property provider must account for any interest expense or income resulting from the section 7701(l) rent-leveling loan, in addition to any interest income or expense resulting from the section 7701(l) note.

Although section 467 may not apply to an obligation-shifting transaction, the effect of the proposed regulations is to recharacterize the transaction to produce the constant rental amount and associated loans that the parties would have been treated as having if the lease or similar agreement had been a section 467 rental agreement (modified to reflect the amounts already received or payable to the property provider immediately before the obligation-shifting transaction) and had been subject to the constant rental accrual method. Thus, the assuming party is treated as if it had purchased the property in part with a note, had obtained the right to receive rental amounts on the constant rental accrual method during its ownership of the property, and had used those amounts to service the note. For the property provider, the proposed regulations provide a recharacterization that is similar (but not identical) to the treatment required when a lessor disposes of property subject to a section 467 rental agreement that was accounted for under the constant rental accrual method.

The proposed regulations provide the exclusive recharacterization of an obligation-shifting transaction for a property provider and an assuming party. Thus, if an obligation-shifting transaction is recharacterized under this section and the lease or similar agreement is a section 467 rental agreement, the rules of this section supersede the rules of §§ 1.467–1 through 1.467–8 as proposed on June 3, 1996 (IA–292–84, 61 FR 27834) for the property provider (the transferor) and the assuming party (the transferee). The assuming party's income after the obligation-shifting transaction is determined under this section and not under § 1.467–7(e)(1). Similarly, the rules provided in § 1.467–7(e)(2) for determining the amount of the section 467 loan for the period after the transfer, the amount realized by the property provider, and the assuming party's basis in the property do not apply to obligation-shifting transactions recharacterized by this section.

The recharacterization does not affect the property user or rent factor (if any), because, even though they are parties to the multiple-party financing transaction, no adjustment to their treatment of the transaction is necessary to prevent the avoidance of tax. *Cf.* § 1.881–3(a)(3)(ii)(A) (limiting purposes for which conduit financing arrangements are recharacterized). Thus, if the lease or similar agreement is a section 467 rental agreement, the property user must continue to take section 467 rent and section 467 interest into account without regard to the obligation-shifting transaction and the recharacterization under this section. *See* § 1.467–7(e)(1).

6. Issues Not Addressed

The proposed regulations do not address transactions in which a taxpayer assigns rights to future income

but does not transfer the underlying property to another taxpayer, except as provided in the special rules regarding pass-through entities and consolidated groups.

7. Proposed Effective Date

Notice 95–53 states that the regulations under section 7701(l) will be effective ''with respect to stripping transactions any significant element of which is entered into or undertaken on or after October 13, 1995.'' The regulations are proposed to adopt the effective date stated in the notice.

Special Analyses

It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the understanding of the IRS that the total number of entities engaging in transactions affected by these regulations is not substantial and, of those entities, most are not small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Therefore, a Regulatory Flexibility Analysis is not required. It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in E.O. 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for April 29, 1997, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 7th Floor, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by April 8, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Jonathan R. Zelnik, Office of the Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.7701(l)–2 also issued under 26 U.S.C. 7701(l). * * *

Par. 2. Section 1.7701(l)–1 is amended as follows:

1. Paragraphs (b)(6) and (b)(7) are revised.

2. Paragraph (b)(8) is added.

The revisions and addition reads as follows:

§ 1.7701(l)–1 Conduit financing arrangements.

* * * * *

(b) * * *

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(6) Section 1.6038A–3(b)(5);

(7) Section 1.6038A–3(c)(2)(vii); and

(8) Section 1.7701(l)–2.

Par. 3. Section 1.7701(l)–2 is added under the center heading ''General Actuarial Valuations'' to read as follows:

§ 1.7701(l)–2 Treatment of obligation-shifting transactions.

(a) *Purpose.* The purpose of this section is to prevent avoidance of tax by parties participating in multiple-party financing transactions that involve an assumption of obligations under a lease or similar agreement. This section should be interpreted in a manner consistent with this purpose.

(b) *In general.* Obligation-shifting transactions as defined in paragraph (h)(1) of this section are recharacterized in the manner described in paragraph (d) of this section unless an exception in paragraph (c) of this section applies.

(c) *Exceptions*—(1) *In general.* Paragraph (d) of this section does not apply if any of the following is satisfied:

(i) The aggregate amounts that have already been received by or are payable to the property provider but are allocable to periods (including partial periods) after the obligation-shifting transaction (as determined under paragraph (g) of this section) are less than or equal to $100,000.

(ii) The sum of the aggregate payments (including contingent payments) under the lease or similar agreement and the aggregate value of other consideration (including contingent consideration) to be received under the lease or similar agreement is not reasonably expected to exceed $250,000. The rules of § 1.467–1(c)(4)(ii)[1] apply in determining the amount described in this paragraph (c)(1)(ii).

(iii) The fair market value of the leased property is less than ten percent of the aggregate fair market value of all of the property (excluding Class I assets as described in § 1.1060–1T(d)(1), Class II assets as described in § 1.1060–1T(d)(2)(i), and debt issued by the property provider) that the property provider transfers to the assuming party as part of the same transaction or series of related transactions. For this purpose, the fair market value of the leased property is the sum of—

(A) The fair market value of the property subject to the lease or similar agreement and transferred in the obligation-shifting transaction, plus

(B) The value of the amounts that have already been received under the lease or similar agreement or are retained by the property provider or any other party but are allocable to periods (including partial periods) after the obligation-shifting transaction.

(iv) The agreement(s) between the property provider and the property user is a disqualified leaseback or long-term agreement within the meaning of § 1.467–3(b).[2]

(v) The transaction is described in section 381(a), unless the transaction is deemed to be an obligation-shifting transaction under paragraph (k) of this section.

(vi) The Commissioner determines that the transaction does not

[1] This section appears in proposed regulations published on June 3, 1996 (IA–292–84, 61 FR 27834, 27839).

[2] This section appears in proposed regulations published on June 3, 1996 (IA–292–84, 61 FR 27834, 17844).

substantially reduce the present value of the tax liability of the assuming party or otherwise result in the avoidance of tax.

(2) *Limitation on exceptions.* The exceptions listed in paragraph (c)(1) of this section do not apply to obligation-shifting transactions entered into with a principal purpose of substantially reducing the present value of the aggregate tax liability of the assuming party, the property provider, and any person whose taxable income is determined (in whole or in part) by reference to the taxable income of the property provider or the assuming party.

(d) *Recharacterization of obligation-shifting transaction*—(1) *In general.* In order to clearly reflect the income of the assuming party and the property provider, an obligation-shifting transaction is recharacterized as follows:

(i) *Assuming party treated as receiving all allocable rents.* The assuming party is treated as acquiring the right to receive (and as receiving when due) all amounts under the lease or similar agreement that are allocable (as determined under paragraph (g) of this section) to periods (including partial periods) after the obligation-shifting transaction. Thus, the assuming party must include these amounts in income in the periods to which they are allocable.

(ii) *Assuming party treated as issuing section 7701(l) note.* The assuming party is treated as issuing to the property provider, as additional consideration in the obligation-shifting transaction, a section 7701(l) note, with terms as described in paragraph (e) of this section. Accordingly, the assuming party and the property provider must account for interest expense and income from the section 7701(l) note in the periods (including partial periods) following the obligation-shifting transaction.

(2) *Section 7701(l) rent-leveling loan and adjustment to property provider's income*—(i) *Section 7701(l) rent-leveling loan.* To account for any differences in timing or amount between payments actually received by the property provider after the obligation-shifting transaction and payments (as described in paragraph (e)(3) of this section) treated as being made under the section 7701(l) note, the property provider is treated as a party to a section 7701(l) rent-leveling loan, with terms as described in paragraph (f) of this section. Accordingly, the property provider must account for interest expense or income (as appropriate) in the periods (including partial periods) following the obligation-shifting transaction.

(ii) *Adjustment to property provider's income.* To account for any differences between amounts previously included by the property provider and amounts that are allocable to periods before the obligation-shifting transaction, on the date on which the obligation-shifting transaction is consummated, the property provider must treat as an item of expense or income (as appropriate)—

(A) The principal balance of the section 7701(l) rent-leveling loan, minus

(B) The principal balance (plus interest not already included in the principal balance) of the property provider's section 467 loan (if any) as determined under the principles of § 1.467–4(a)(4)[3] and existing as of that date.

(3) *Exclusive recharacterization.* If the lease or similar agreement is a section 467 rental agreement, the property provider and the assuming party must account for the recharacterized transaction under the provisions of this section and not under the provisions of §§ 1.467–1 through 1.467–8.[4]

(e) *Section 7701(l) note*—(1) *Principal.* On the date on which the obligation-shifting transaction is consummated, the principal balance of the section 7701(l) note equals the excess of—

(i) The present value of the amounts that are allocable to periods (including partial periods) after the obligation-shifting transaction, over

(ii) The present value of the amounts that are payable to the assuming party.

(2) *Present value, yield, and compounding period.* For purposes of paragraph (e)(1) of this section, present value is determined under the rules of § 1.467–2(d)[5]. The yield of the section 7701(l) note equals 110 percent of the applicable Federal rate on the date on which the obligation-shifting transaction is consummated, based on the remaining term of the lease or similar agreement. The compounding period for determining both the original principal balance and the yield must equal the period used in determining the amounts that are allocable (as determined under paragraph (g) of this section) to periods under the lease or similar agreement.

(3) *Repayment schedule*—(i) *Amount.* The payment for each period under the section 7701(l) note is—

(A) The amount that is taken into account by the assuming party under paragraph (d)(1)(i) of this section, minus

(B) The amount received by the assuming party for that period.

(ii) *Timing.* The timing of section 7701(l) note payments, as determined under paragraph (e)(3)(i) of this section, is the same as the timing of the payments taken into account by the assuming party under paragraph (d)(1)(i) of this section.

(4) *Debt for all purposes.* A section 7701(l) note is debt for all purposes of the Internal Revenue Code. The principal balance of the section 7701(l) note after the obligation-shifting transaction may be positive or negative. If the principal balance is positive, the note represents an amount owed by the assuming party to the property provider, and if the principal balance is negative, the note represents an amount owed by the property provider to the assuming party.

(f) *Section 7701(l) rent-leveling loan*—(1) *Principal.* On the date on which the obligation-shifting transaction is consummated, the principal balance of the section 7701(l) rent-leveling loan equals the principal balance (plus any interest not already included in the principal balance) of the section 467 loan as determined under § 1.467–4(b) that would have existed as of that date if—

(i) The amounts payable under the lease or similar agreement were the amounts described in paragraphs (g)(1) and (g)(2) of this section, and

(ii) The property provider had reported all items of income and expense with respect to the lease or similar agreement by applying the constant rental accrual method described in § 1.467–3(d) and by determining the section 467 rent for each period in accordance with § 1.467–1(d)(2)(i).

(2) *Yield and compounding period.* The yield of the section 7701(l) rent-leveling loan equals 110 percent of the applicable Federal rate on the date on which the obligation-shifting transaction is consummated, based on the original term of the lease or similar agreement. The compounding period for determining the yield must equal the period used in determining the amounts that are allocable (as determined under paragraph (g) of this section) to periods under the lease or similar agreement.

(3) *Repayment schedule*—(i) *Amount.* The property provider's payment (or receipt) for each period under the section 7701(l) rent-leveling loan is—

(A) The amount (as described in paragraph (e)(3)(i) of this section)

[3] This section appears in proposed regulation published on June 3, 1996 (IA–292–84, 61 FR 27834, 27845).

[4] These sections appear in proposed regulations published on June 3, 1996 (IA–292–84, 61 FR 27834).

[5] This section appears in proposed regulations published on June 3, 1996 (IA–292–84, 61 FR 27834, 27842).

treated as paid in satisfaction of the section 7701(l) note, minus

(B) The amount received by the property provider under the lease or similar agreement for that period.

(ii) *Timing.* The timing of section 7701(l) rent-leveling loan payments, as determined under paragraph (f)(3)(i) of this section, is governed by paragraph (g) of this section (and thus, is the same as the timing of the payments taken into account by the assuming party under paragraph (d)(1)(i) of this section).

(4) *Debt for all purposes.* A section 7701(l) rent-leveling loan is debt for all purposes of the Internal Revenue Code. The principal balance of the section 7701(l) rent-leveling loan may be positive or negative. If the principal balance is positive, the amount represents a loan on which the property provider is the obligee, and if the principal balance is negative, the amount represents a loan on which the property provider is the obligor.

(g) *Determining amounts that are allocable to periods under the lease or similar agreement.* The amounts that are allocable to periods under a lease or similar agreement are determined (immediately before the obligation-shifting transaction is consummated) by applying the constant rental accrual method described in § 1.467–3(d) from the inception of the lease or similar agreement based on—

(1) The amounts that have already been received under the lease or similar agreement, and

(2) The amounts that are payable under the lease or similar agreement.

(h) *Definitions.* The following definitions apply solely for purposes of this section.

(1) An *obligation-shifting transaction* is any transaction in which an assuming party assumes a property provider's obligations to a property user (or acquires property subject to a property provider's obligations to a property user) under a lease or similar agreement if the property provider or any other party has already received, or retains the right to receive, amounts that are allocable to periods after the transaction.

(2) A *property user* is any person with the right to use property under a lease or similar agreement.

(3) A *property provider* is any person (other than an assuming party in its capacity as such) that is obligated to make property available to a property user on account of a lease or similar agreement.

(4) An *assuming party* is any person that assumes obligations or acquires property subject to obligations under an existing lease or similar agreement with a property user.

(5) A *lease or similar agreement* is any contract for the use or enjoyment of tangible or intangible property, including leaseholds, licenses, other non-fee interests in property, and other contracts (including service contracts) involving the use or enjoyment of property if the fair market value of that use or enjoyment is more than de minimis.

(6) *Obligations under a lease or similar agreement* include the continuing obligation to make property subject to a lease or similar agreement available to a property user. To the extent that an assuming party assumes obligations of a property provider or acquires property subject to obligations of a property provider, the obligations shall not thereafter be treated as obligations of the property provider.

(7) *Amounts that have already been received under the lease or similar agreement* include consideration received (as of the date on which the obligation-shifting transaction is consummated) for assigning the rights to receive payments under the lease or similar agreement.

(8) *Amounts that are payable under the lease or similar agreement* do not include payments the rights to which have been assigned in an arm's-length transaction to an unrelated third person in exchange for consideration.

(9) A *section 7701(l) note* is indebtedness arising from the recharacterization described in paragraph (d)(1)(ii) of this section. The terms of a section 7701(l) note are described in paragraph (e) of this section.

(10) A *section 7701(l) rent-leveling loan* is indebtedness arising from the recharacterization described in paragraph (d)(2)(i) of this section. The terms of a section 7701(l) rent-leveling loan are described in paragraph (f) of this section.

(i) *Reserved.*

(j) *Pass-through entity look-through rule.* For purposes of determining whether any person is a property user, a property provider, or an assuming party, the person is treated as having the rights and obligations of any pass-through entity in which the person is a partner, shareholder, beneficiary, or other participant, but only to the extent of the person's allocable share of pass-through entity items relating to the property. The pass-through entity must reflect the required recharacterization on its books.

(k) *Consolidated group rule.* For purposes of this section, if a subsidiary is a member of a consolidated group and the subsidiary or a successor becomes a nonmember (other than in a transaction described in § 1.1502–13(j)(5)), the nonmember (whether or not a separate legal entity) will be treated as a separate corporation that acquires the assets and assumes the obligations of the subsidiary. For example, assume that P sells all the stock of S, previously a wholly-owned subsidiary of P and a member of the P consolidated group, and that, at the time of the sale, S already has received amounts under a lease that are allocable to periods after the sale. Under this paragraph (k), an obligation-shifting transaction occurs when S becomes a nonmember. S, as a nonmember, is treated as having assumed the obligations under the lease. Therefore, S must adjust its income as provided in paragraph (d)(2)(ii) of this section immediately before it becomes a nonmember of the consolidated group. After the sale, S is treated as both a property provider and an assuming party in the obligation-shifting transaction.

(l) *Reserved.*

(m) *Examples.* The following examples illustrate the rules of this section. Each example assumes that all taxpayers use the calendar year as the taxable year, all payment periods are the calendar year, and none of the rental agreements are disqualified leasebacks or long-term agreements under § 1.467–3(b). Except as otherwise provided, none of the exceptions in paragraph (c)(1) of this section apply. The examples read as follows:

Example 1. *Retained rents; section 351 transfer*—(i) *Facts.* (A) On January 1, 2001, A leases property to B for a five-year period. The lease provides for rent of $10,000,000 per year, payable annually on December 31.

(B) On January 1, 2002, A transfers the leased property to D in exchange for D preferred stock. A retains the right to receive the remaining four years of rent from B. As part of the same transaction, C transfers $100,000,000 to D in exchange for D common stock. After the transaction, A and C own 100 percent of the stock of D. Assume the transaction meets all of the requirements of section 351. C and D are members of the same consolidated group as defined in § 1.1502–1(h). One hundred ten percent of the applicable Federal rate based on annual compounding is 7 percent.

(ii) *Obligation-shifting transaction.* B is a property user because B has the right to use the property under the lease with A. A is a property provider because A is obligated to make the property available to B on account of the lease. D is an assuming party because in the January 1, 2002, transaction D acquires the property subject to A's obligations under the lease to make the property available to B for the remaining four years of the lease. The transaction is an obligation-shifting transaction because D is an assuming party

and A retains the right to receive rent from B allocable to periods after the transaction.

(iii) *Recharacterization.* As of January 1, 2002, the transaction is recharacterized as follows:

(A) Under the constant rental accrual method described in § 1.467–3(d), the amount accruing for each calendar year period under the lease is $10,000,000. D is treated as acquiring the right to receive the amounts allocable to the four periods after the obligation-shifting transaction. Thus, in 2002, 2003, 2004, and 2005, D must recognize $10,000,000 rental income.

(B) The principal balance of the section 7701(l) note equals $33,872,112.56, with a yield equal to 7 percent based on annual compounding. As part of the obligation-shifting transaction, D is treated as having given A the section 7701(l) note as additional consideration. The amount of the section 7701(l) note is treated as ''other property'' transferred from D to A in the section 351 exchange. D is treated as making section 7701(l) note payments to A. A has interest income on the section 7701(l) note. D has interest expense on the section 7701(l) note. A and D account for the section 7701(l) note as follows:

SECTION 7701(1) NOTE

Taxable year ending	Beginning balance	Payment	Interest	Principal
12/31/02	$33,872,112.56	$10,000,000.00	$2,371,047.88	$7,628,952.12
12/31/03	26,243,160.44	10,000,000.00	1,837,021.23	8,162,978.77
12/31/04	18,080,181.67	10,000,000.00	1,265,612.72	8,734,387.28
12/31/05	9,345,794.39	10,000,000.00	654,205.61	9,345,794.39

(C) Because the amount A recognized in the year before the obligation-shifting transaction equals the amount A would have recognized under the constant rental accrual method, A's adjustment to income on the consummation of the obligation-shifting transaction is $0.

(D) At the time of the obligation-shifting transaction, the principal balance of the section 7701(l) rent-leveling loan equals $0. Furthermore, because the amounts A actually receives each year after the obligation-shifting transaction, $10,000,000, equal the amounts D is treated as paying A under the section 7701(l) note, $10,000,000, the balance of the section 7701(l) rent-leveling loan equals $0 for all periods after the obligation-shifting transaction. Thus, A has no interest income or expense arising from the section 7701(l) rent-leveling loan.

Example 2. *Rents already received; section 351 transfer*—(i) Facts. (A) On January 1, 2001, X leases property to Y for a seven-year period. The XY lease provides for rent of $900,000 per year, payable annually on December 31. Also on January 1, 2001, Y leases the property to Z for a five-year period. The YZ lease provides for rent payable on December 31 of each year as follows: $800,000 in 2001, $900,000 in 2002, $1,000,000 in 2003, $1,100,000 in 2004, and $1,200,000 in 2005.

(B) On December 31, 2001, Y sells to F the right to receive all rents from Z for 2002 through 2005. F pays Y $3,146,345.27. Y includes the $3,146,345.27 as ordinary income.

(C) On January 1, 2002, Y contributes to S cash of $2,500,000, Y's rights and obligations under the lease with X, and Y's rights and obligations under the lease with Z in exchange for S preferred stock. As part of the same transaction, P transfers cash of $7,500,000 to S in exchange for S common stock. After the transaction, Y and P own 100 percent of the stock of S. Assume the transaction meets all of the requirements of section 351. S and P are members of the same consolidated group as defined in § 1.1502–1(h). One hundred ten percent of the applicable Federal rate based on annual compounding is 10 percent.

(ii) *Obligation-shifting transaction.* Z is a property user because Z has the right to use the property under the YZ lease. Y is a property provider because Y is obligated to make the property available to Z. S is an assuming party because in the January 1, 2002, transaction, S assumes Y's obligations under the YZ lease to make the property available for the remaining four years of the lease. The transaction is an obligation-shifting transaction because S is an assuming party and Y has already received amounts allocable to periods after the transaction (Y sold to F the right to receive rent payments under the YZ lease for 2002 through 2005).

(iii) *Recharacterization.* As of January 1, 2002, the transaction is recharacterized as follows:

(A) Under the constant rental accrual method described in § 1.467–3(d), the amount accruing for each calendar year period under the YZ lease is $946,396.31, based on the $800,000 Y received from Z on December 31, 2001, and the $3,146,345.27 Y received from F on December 31, 2001. S is treated as acquiring the right to receive the amounts allocable to the four periods after the obligation-shifting transaction. Thus, S must recognize $946,396.31 of rental income for each of the four periods following the obligation-shifting transaction.

(B) The principal balance of the section 7701(l) note equals $2,999,948.96, with a yield equal to 10 percent based on annual compounding. As part of the obligation-shifting transaction, S is treated as having given Y the section 7701(l) note as additional consideration. The amount of the section 7701(l) note is treated as ''other property'' transferred from S to Y in the section 351 exchange. S is treated as making section 7701(l) note payments to Y. Y has interest income on the section 7701(l) note. S has interest expense on the section 7701(l) note. S and Y account for the section 7701(l) note as follows:

SECTION 7701(l) NOTE

Taxable year ending	Beginning balance	Payment	Interest	Principal
12/31/02	$2,999,948.96	$946,396.31	$299,994.90	$646,401.41
12/31/03	2,353,547.55	946,396.31	235,354.75	711,041.56
12/31/04	1,642,505.99	946,396.31	164,250.60	782,145.71
12/31/05	860,360.28	946,396.31	86,036.03	860,360.28

(C) At the time of the obligation-shifting transaction, the principal balance of the section 467 loan that would have existed if Y had reported all items of income and expense by applying the constant rental accrual method equals negative $2,999,948.96. Thus, in computing its income on the consummation of the obligation-shifting transaction, Y must take into account an expense equal to $2,999,948.96.

(D) At the time of the obligation-shifting transaction, the principal balance of the section 7701(l) rent-leveling loan equals negative $2,999,948.96. Y must account for the section 7701(l) rent-leveling loan as follows:

SECTION 7701(l) RENT-LEVELING LOAN

Taxable year ending	Beginning balance	Payment	Interest	Principal
12/31/02	($2,999,948.96)	($946,396.31)	($299,994.90)	($646,401.41)
12/31/03	(2,353,547.55)	(946,396.31)	(235,354.75)	(711,041.56)
12/31/04	(1,642,505.99)	(946,396.31)	(164,250.60)	(782,145.71)
12/31/05	(860,360.28)	(946,396.31)	(86,036.03)	(860,360.28)

Example 3. *Rents already received; sale of a partnership interest*—(i) *Facts.* (A) On January 1, 2001, A, B, and C form partnership PRS by contributing $3,600,000, $396,000, and $4,000, respectively, for proportionate interests (90.0 percent, 9.9 percent, and 0.1 percent, respectively) in the capital and profits of PRS. On the same day, PRS purchases property for $4,000,000 and leases the property to X for a five-year period. The lease provides for rent payable on December 31 of each year as follows: $800,000 in 2001, $900,000 in 2002, $1,000,000 in 2003, $1,100,000 in 2004, and $1,200,000 in 2005.

(B) On December 31, 2001, PRS sells to F the right to receive all rents from X for 2002 through 2005. F pays PRS $3,146,345.27. PRS treats the $3,146,345.27 as ordinary income allocated $2,831,710.74 to A, $311,488.18 to B, and $3,146.35 to C. One hundred ten percent of the applicable Federal rate based on annual compounding is 10 percent.

(C) Immediately following the sale of the rents, A sells its entire partnership interest to D based on the fair market value of 90 percent of PRS's assets. PRS does not have an election in effect under section 754.

(ii) *Obligation-shifting transaction.* X is a property user because X has the right to use the property under the lease with PRS. A is a property provider as to its share of the partnership's obligations under the lease to make the property available to X. D is an assuming party because D acquires A's partnership interest subject to A's share of the partnership's obligations under the lease with X to make the property available for the remaining four years of the agreement. The transaction is an obligation-shifting transaction because D is an assuming party and A has already received income allocable to periods after the transaction (A received allocations of income from the sale of the right to receive rents under the lease in 2002 through 2005). Thus, D is treated as assuming 90 percent of the partnership's obligations under the lease.

(iii) *Recharacterization.* As of January 1, 2002, the transaction is recharacterized as follows:

(A) Under the constant rental accrual method described in § 1.467–3(d), the amount accruing for each calendar year period under the lease is $946,396.31, based on the $800,000 PRS received from X and the $3,146,345.27 PRS received from F. A's share of the amount payable in each calendar year period under the lease is $851,756.68 (90 percent of $946,396.31). D is treated as acquiring the right to A's 90 percent share of the amounts allocable to the four periods after the obligation-shifting transaction. Thus, D must recognize $851,756.68 of rental income for each of the four periods following the obligation-shifting transaction.

(B) The principal balance of the section 7701(l) note equals $2,699,954.06, with a yield equal to 10 percent based on annual compounding. As part of the obligation-shifting transaction, D is treated as having given A the section 7701(l) note as additional consideration. D is treated as making section 7701(l) note payments to A. A has interest income on the section 7701(l) note. D has interest expense on the section 7701(l) note. A and D account for the section 7701(l) note as follows:

SECTION 7701(l) NOTE

Taxable year ending	Beginning balance	Payment	Interest	Principal
12/31/02	$2,699,954.06	$851,756.68	$269,995.41	$581,761.27
12/31/03	2,118,192.79	851,756.68	211,819.28	639,937.40
12/31/04	1,478,255.39	851,756.68	147,825.54	703,931.14
12/31/05	774,324.25	851,756.68	77,432.42	774,324.26

(C) At the time of the obligation-shifting transaction, the principal balance of the section 467 loan that would have existed if PRS had reported all items of income and expense by applying the constant rental accrual method equals negative $2,999,948.96. Thus, in computing its income on the consummation of the obligation-shifting transaction, A must take into account an expense equal to $2,699,954.06 (90 percent of $2,999,948.96).

(D) At the time of the obligation shifting transaction, the principal balance of the section 7701(l) rent-leveling loan equals negative $2,699,954.06. A must account for the section 7701(l) rent-leveling loan as follows:

SECTION 7701(l) RENT-LEVELING LOAN

Taxable year ending	Beginning balance	Payment	Interest	Principal
12/31/02	($2,699,954.06)	($851,756.68)	($269,995.41)	($581,761.27)
12/31/03	(2,118,192.79)	(851,756.68)	(211,819.28)	(639,937.40)
12/31/04	(1,478,255.39)	(851,756.68)	(147,825.54)	(703,931.14)
12/31/05	(774,324.25)	(851,756.68)	(77,432.42)	(774,324.26)

Example 4. *Exception where aggregate amounts retained or already received are less than or equal to $100,000; section 351 transfer*—(i) *Facts.* (A) On January 1, 2001, A leases property to B for a five-year period. The lease provides for rent of $1,000,000 for 2001, and $875,000 for the each of the remaining four years of the lease. Rent is payable annually on December 31.

(B) On January 1, 2002, A transfers the leased property along with the right to receive rent payments for 2002 through 2005 to D in exchange for D preferred stock. As part of the same transaction, C transfers $1,000,000 to D in exchange for D common stock. After the transaction, A and C own 100 percent of the stock of D. Assume that the transaction meets all of the requirements of

section 351. C and D are members of the same consolidated group as described in § 1.1502–1(h). Assume that A, C, and D did not enter into the transaction with a principal purpose of substantially reducing the present value of their aggregate tax liabilities. One hundred ten percent of the applicable Federal rate based on annual compounding is 7 percent.

(ii) *Obligation-shifting transaction.* A is a property provider because it is obligated to make property available to B on account of a lease or similar agreement. B is a property user because it has the right to use property under its lease with A. D is an assuming party because, in the January 1, 2002, transaction, it acquires the property subject to A's obligation to make the property available to B for the remaining term of the lease. The transaction between A and D is an obligation-shifting transaction because D is an assuming party and A retains the right to receive amounts from B allocable to periods after the transaction.

(iii) *Availability of exception.* Even though the transaction between A and D is an obligation-shifting transaction, it is not recharacterized under this section. As of the date of the transaction, A has already received $1,000,000. Under the constant rental accrual method described in § 1.467–3(d), the constant rental amount accruing for each calendar year during the lease is $903,491.90. The aggregate amount that has already been received by A but that is allocable to periods after the obligation-shifting transaction is $1,000,000 minus $903,491.90, or $96,508.10. Because this amount is less than $100,000, the transaction is excepted from recharacterization under paragraph (c)(1)(i) of this section.

Example 5. *Exception where fair market value of leased property is less than 10 percent of value of all property transferred; incorporation of existing business*—(i) *Facts.* (A) On January 1, 2001, A leases property to B for a five-year period. The lease provides for rent of $1,000,000 per year, payable annually on December 31.

(B) On January 1, 2003, the fair market value of the leased property is $4,000,000. On that date, A transfers the property, together with $3,000,000 of Class I and Class II assets and other property with a fair market value of $39,000,000, in exchange for all of the common stock of C. A retains the right to receive the remaining three rent payments from B. The fair market value of the rent payments retained by A is $2,486,851.99 (based on a discount rate of 10 percent). The fair market value of the property subject to the lease and transferred to B, reflecting A's retention of the right to the remaining three rent payments, is $1,513,148.01. Assume that the transaction meets all of the requirements of section 351. Assume that A and C did not enter into the transaction with a principal purpose of substantially reducing the present value of their aggregate tax liabilities.

(ii) *Obligation-shifting transaction.* A is a property provider because it is obligated to make property available to B on account of a lease or similar agreement. B is a property user because it has the right to use property under its lease with A. C is an assuming party because, in the January 1, 2003, transaction, it acquires the property subject to A's obligation to make the property available to B for the remaining three years of the lease. The transaction between A and C is an obligation-shifting transaction because C is an assuming party and A retains the right to receive amounts from B allocable to periods after the transaction.

(iii) *Availability of exception.* Even though the transaction between A and C is an obligation-shifting transaction, it is not recharacterized under this section. The fair market value of the leased property equals $4,000,000. The fair market value of the property subject to the lease and transferred to B is $1,513,148.01, and the fair market value of the rents retained is $2,486,851.99. The aggregate fair market value of all of the property transferred, excluding Class I assets, Class II assets, and debt issued by the property provider, as part of the same transaction is $43,000,000 ($4,000,000 leased property plus $39,000,000 other property, excluding Class I assets, Class II assets, and debt issued by the property provider). Because the value of the leased property, $4,000,000, is less than 10 percent of $43,000,000, the transaction is excepted from recharacterization under paragraph (c)(1)(iii) of this section.

(n) *Effective date.* This section applies to obligation-shifting transactions any significant element of which was entered into or undertaken on or after October 13, 1995.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

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BILLING CODE 4830–01–P

DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 203

RIN 0790–AG14

Technical Assistance for Public Participation (TAPP) in Defense Environmental Restoration Activities

AGENCY: Office of the Deputy Under Secretary of Defense for Environmental Security (DUSD(ES)), DOD.

ACTION: Proposed rule.

SUMMARY: Pursuant to the National Defense Authorization Act of 1996, the Department of Defense proposes these regulations on providing technical assistance to local community members of Restoration Advisory Boards (RABs) and Technical Review Committee (TRCs). RABs and TRCs are established to review and comment on Department of Defense actions at military installations undertaking environmental restoration's activities.

DATES: Written comments must be received on or before February 25, 1997.

ADDRESSES: Send written comments and requests for documents to the Office of the Deputy Under Secretary for Environmental Security/Cleanup, 3400 Defense Pentagon, Washington, DC 20301–3400. Comments may also be submitted electronically by sending electronic mail (e-mail) to: ferrebpl@acq.osd.mil.

FOR FURTHER INFORMATION CONTACT: Patricia Ferrebee or Marcia Read, telephone (703) 697–5372 or (703) 697–7475.

SUPPLEMENTARY INFORMATION:

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I. Introduction

A. Authority

This proposed rule is issued under the authority of § 2705 of Title 10, United States Code. Subsections (c) and (d) of Section 2705 encourage the Department of Defense to establish either a Technical Review Committee (TRC) or Restoration Advisory Board (RAB) to review and comment on DoD actions at military installations undertaking environmental restoration activities. In 1994, Congress authorized the Department of Defense to develop a program to facilitate public participation by providing technical assistance to local community members of TRCs and RABs (section 326 of the National Defense Authorization Act for Fiscal Year 1995, P.L. 103–337). In 1996, Congress revised this authority (section 324 of the National Defense authorization Act for Fiscal Year 1996,