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Prop. Reg. Section 1.7872-6

Timing and amount of transfers in connection with gift loans and demand loans

(a) In general. Section 7872(a) and the provisions of this section govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender in the case of a below-market demand loan. Section 7872(a) and this section also govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender from income tax purposes in the case of term gift loans. (See section 7872(b), 7872(d)(2), and §1.7872-7 for rules governing the timing and the amount of the imputed transfer by the lender to the borrower in the case of term gift loans for gift tax purposes.) Section 7872(d)(1) and §1.7872-8 limit the amount of the imputed interest payment with respect to certain gift loans. See §1.7872-10(a) for rules for distinguishing demand loans from term loans. See §1.7872-11(f) for special rules governing loans repayable in foreign currency, which apply notwithstanding any contrary rules set forth in this section.

(b) Time of transfer.

(1) In general. Except as otherwise provided in paragraphs (b)(3), (4), and (5) of this section, the foregone interest (as defined in section 7872(e)(2) and paragraph (c) of this section) attributable to periods during any calendar year is treated as transferred by the lender to the borrower (and retransferred by the borrower to the lender) on December 31 of that calendar year and shall be treated for tax purposes in a manner consistent with the taxpayer's method of accounting.

(2) Example. Paragraph (b)(1) of this section may be illustrated by the following example.

Example. On January 1, 1985, E makes a \$200,000 interest-free demand loan to F, an employee of E. The loan remains outstanding for the entire 1985 calendar year. E has a taxable year ending September 30. F is a calendar year taxpayer. For 1985, the imputed compensation payment and the imputed interest payment (as computed under paragraph (c) of this section) are treated as made on December 31.

(3) Gift loans between natural persons. In the case of gift loans directly between natural persons within the meaning of § 1.7872-8(a)(2), any imputed transfer and any imputed interest payment to which this section applies during the borrower's taxable year is treated, for both the lender and the borrower, as occurring on the last day of the borrower's taxable year.

(4) Death, liquidation or termination of borrower. If the borrower dies (in the case of a borrower who is a natural person) or is liquidated or otherwise terminated (in the case of a borrower other than a natural person), any imputed transfer and any imputed interest

payment arising during the borrower's final taxable year are treated, for both the lender and the borrower as occurring on the last day of the borrower's final taxable year.

(5) Repayment of loan. If a below-market loan is repaid, any imputed transfer and any imputed interest payment arising during the borrower's taxable year which includes the date of repayment is treated, for both the lender and the borrower, as occurring on the day the loan is repaid.

(c) Amount of transfer. In the case of a below-market loan to which section 7872 applies and which is a demand loan (including a term loan that is treated as a demand loan as provided in section §1.7872-10(a)(5)) or a gift term loan, the foregone interest (as computed under the provisions of § 1.7872-13) with respect to the loan is treated as transferred by the lender to the borrower and retransferred as interest by the borrower to the lender. Generally, for any calendar year the term "foregone interest" means the excess of-

(1) The amount of interest that would have been payable in that year if interest had accrued at the applicable Federal rate (as determined in §1.7872-13); over

(2) Any interest payable on the loan properly allocable to that year.

The amount of foregone interest is computed for each day during the period for which section 7872(a) applies to the loan and is treated as transferred and retransferred on the date specified in paragraph (b) of this section.