

Prop. Reg. Section 1.7872-8(b)

Special rules for gift loans directly between natural persons

(a) Special rules for gift loans directly between natural persons.

(1) In general. Section 7872(c)(2) and (d) apply special rules to gift loans directly between natural persons if the aggregate outstanding amount of loans (as determined in paragraph (b)(2) of this section) between those natural persons does not exceed specified limitations.

(2) Loans directly between natural persons.

(i) For purposes of this section, a loan is made directly between natural persons only if both the lender and borrower are natural persons. For this purpose, a loan by a natural person lender to the guardian (or custodian, in the case of a gift made pursuant to the Uniform Gift to Minors Act) of a natural person is treated as a loan directly between natural persons. If, however, a parent lends money to a trust of which the child is the sole beneficiary, the loan is not treated as directly between natural persons for purposes of this section.

(ii) A gift loan which results from restructuring an indirect loan as two or more loans (as described in § 1.7872-4(g)) and in which natural persons are deemed to be the lender and the borrower is treated as a loan directly between natural persons. Thus, for example, if an employer makes a below-market loan to an employee's child, the loan is restructured as one loan from the employer to the employee, and a second loan from the employee to his child. The deemed gift loan between the employee and the employee's child is treated as directly between natural persons.



(b) De minimis exception.

(1) In general. Except as otherwise provided in paragraph (b)(3) of this section or in § 1.7872-7(a) (with respect to the gift tax consequences of a gift term loan to which the provisions of section 7872 have already been applied), in the case of any gift loan directly between natural persons, the provisions of section 7872 do not apply to any loan outstanding on any day on which the aggregate outstanding amount of loans between the lender and borrower does not exceed \$10,000. The de minimis rule of this paragraph (b)(1) applies with respect to a gift loan even though that loan could also be characterized as a tax avoidance loan within the meaning of section 7872(c)(1)(D) and § 1.7872-4(e).

(2) Aggregate outstanding amount of loans. The aggregate outstanding amount of loans between natural persons is the sum of the principal amounts of outstanding loans directly between the individuals, regardless of the character of the loans, regardless of the interest rate charged on the loans, and regardless of the date on which the loans were made. For this purpose, the principal amount of a loan which is also subject to section 1272 (without

applying the limitation of section 1273(a)(3)) is the "adjusted issue price" as that term is defined in section 1272(a)(4). See § 1.7872-7(a)(3)(i) for the determination of the issue price of a loan which is also subject to section 1272.

(3)Loans attributable to acquisition or carrying of income-producing assets. The de minimis exception described in paragraph (b)(1) of this section does not apply to any gift loan directly attributable to the purchase or carrying of income-producing assets. A gift loan is directly attributable to the purchase or carrying of income-producing assets, for example, if the loan proceeds are directly traceable to the purchase of the income-producing assets, the assets are used as collateral for the loan, or there is direct evidence that the loan was made to avoid disposition of the assets.

(4)Income-producing assets. For purposes of this paragraph (b), the term "income-producing asset" means (i) an asset of a type that generates ordinary income, or, (ii) a market discount bond issued before July 19, 1984. Accordingly, an income producing asset includes, but is not limited to, a business, a certificate of deposit, a savings account, stock (whether or not dividends are paid), bonds and rental property.

(5)Examples. The provisions of this paragraph (b) may be illustrated by the following examples.

Example (1).

(i) As of January 1, 1985, the total aggregate outstanding amount of loans by Parent P, to child, C, is \$6,000. None of these loans is a below-market loan. On February 1, 1985, P makes a \$3,000 below-market demand loan to C. On March 1, 1985, P makes a \$2,000 below-market demand loan to C. On November 1, 1985, C repays \$1,500 of principal of the market-rate loans to P; all of the other loans remain outstanding as of December 31, 1985. The below-market loans are gift loans and are the only new loans between P and C for calendar year 1985.

(ii) For the periods January 1, 1985, through February 28, 1985, and November 1, 1985, through December 31, 1985, section 7872 does not apply to the loans between P and C because the outstanding loan balance between P and C does not exceed \$10,000 during these periods. For the period beginning on March 1, 1985, and ending on October 31, 1985, however, the aggregate outstanding amount of loans directly between P and C exceeds \$10,000. Accordingly, the provisions of section 7872(a) apply to the \$3,000 gift loan and \$2,000 gift loan during that period.

Example (2).

(i) Assume the same facts as in Example (1) except that the \$2,000 gift loan made on March 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the \$3,000 gift demand loan made on February 1, 1985, are the same as in Example (1).

(ii) With respect to the \$2,000 gift term loan, section 7872(b)(1) applies beginning on March 1, 1985, for purposes of computing the amount on the imputed gift by P to C. For the period beginning on March 1, 1985, and ending on October 31, 1985, section 7872(a) applies to the \$2,000 gift term loan for purposes of determining the amount and the

timing of the imputed interest payment by C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the \$2,000 loan for Federal income tax purposes because the outstanding loan balance between P and C does not exceed \$10,000 during this period.

Example (3).

(i) Assume the same facts as in Example (1) except that the \$3,000 gift loan made on February 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the \$2,000 demand gift loan made on March 1, 1985, are identical to those in Example (1).

(ii) On February 1, 1985, section 7872 does not apply to the \$3,000 loan because the outstanding loan balance between P and C does not exceed \$10,000. On March 1, 1985, however, the aggregate outstanding amount of loans between P and C exceeds \$10,000. For Federal gift tax purposes, section 7872(b)(1) applies to the \$3,000 loan beginning on March 1, 1985. Under §1.7872-7(b), the provisions of section 7872 apply to the loan had been made on March 1, 1985. See §1.7872-7(a)(5) for special rules for computing the present value of payments due on the loan. For the eight-month period beginning on March 1, 1985, section 7872(a) applies to the \$3,000 loan for purposes of determining the imputed interest payment by C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the \$3,000 loan for Federal income tax purposes because of the application of the de minimis provisions .

Example (4). On June 10, 1984, parent, L, makes an \$8,000 interest-free gift term loan to L's child, B. This is the only loan outstanding between L and B during 1984. On June 11, 1984, B invests the \$8,000 in corporate stock. The \$10,000 de minimis provision does not apply to the loan, because the loan proceeds are directly attributable to the purchase of corporate stock, an income-producing asset.

(c) Limitation on amount of imputed interest payment.

(1) In general. In the case of a loan between a borrower and a lender both of whom are natural persons (within the meaning of paragraph (a)(2) of this section), for all days during the borrower's taxable year on which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and the lender, is \$100,000 or less, the amount of the imputed interest payment by the borrower to the lender with respect to any gift loan is limited to the borrower's net investment income (as determined under paragraph (c)(7) of this section) for the taxable year. This paragraph (c) does not affect the gift tax consequences of any loan under section 7872.

(2) Tax avoidance loan. Paragraph (c)(1) of this section does not apply to any loan which is a tax avoidance loan within the meaning of §1.7872-4(e).

(3) No limitation if investment income is manipulated. Paragraph (c)(1) of this section does not apply if a borrower can control the timing of the receipt of investment income and actually does manipulate the timing to accelerate or defer the receipt of investment income. For example, if the borrower can, and actually does, control the timing of dividends paid by a closely held corporation, the limitation on the amount of the imputed interest payment does not apply.

(4) Net investment income of \$1,000 or less disregarded. If paragraph (c)(1) of this section applies and if the borrower's net investment income (as determined under paragraph (c)(7) of this section) for a taxable year is \$1,000 or less, the borrower's net investment income for that year is deemed to be zero for purposes of this paragraph (c).

(5) No proration of net investment income. The entire amount of the borrower's net investment income for a taxable year (as determined under paragraph (c)(7) of this section) is taken into account in determining the maximum imputed interest payment for those days during the year on which the net investment income limitation applies. Accordingly, the amount of net investment income is not allocated among the days of the borrower's taxable year. Further, for a taxable year of a borrower which ends after June 6, 1984, and includes any day or days before June 7, 1984, the entire amount of net investment income for the taxable year is taken into account in determining the maximum imputed interest payment for the days during that year on which the limitation applies.

(6) Allocation among gift loans. In the case of a borrower who has more than one gift loan outstanding during a taxable year, the borrower's net investment income for that year is allocated among the gift loans in proportion to the respective amounts which would be treated as imputed interest payments by the borrower to the lender or lenders with respect to those loans without regard to this paragraph (c). (See Example (2) of paragraph (c)(9) of this section.) No amount of the net investment income is allocable to any gift loan between the lender and the borrower for periods during which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and that lender exceeds \$100,000.

(7) Amounts included in net investment income. For purposes of section 7872, net investment income for a taxable year equals the sum of-

payment obligation.

(8) Deferred payment obligation. The term "deferred payment obligation" means a market discount bond issued before July 18, 1984, or an obligation that, if held to maturity, would produce a predictable and regular flow of ordinary income which, under applicable tax rules, is not recognized until a subsequent period. Accordingly, deferred payment obligations include, but are not limited to, those obligations listed in section 7872(d)(1)(E)(iv).

(9) Examples. The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). On January 1, 1985, parent P makes a \$50,000 below-market gift loan to C. P's child, who uses the calendar year as the taxable year. On March 1, 1985, P makes an additional \$75,000 market-rate loan to C. On October 1, 1985, C repays \$30,000 of the market rate loan. Assume that C's net investment income (as determined under paragraph (c)(7) of this section) for 1985 is \$2,400. The limitation under section 7872(d)(1) on the amount of imputed interest payment applies to the \$50,000 loans for the two-month period beginning on January 1, 1985, and the three-month period beginning on October 1, 1985. Accordingly, the imputed interest payment on the \$50,000 loan for 1985 may not exceed \$2,400.

Example (2). During 1985, natural person borrower B has three gift loans outstanding, each from a different lender. Each loan is eligible for the entire year for the special limitation on the amount of imputed interest payments under section 7872(d)(1) but none of the loans is eligible for the de minimis exception of paragraph (b) of this section. B's net investment income for 1985 is \$6,000. The aggregate imputed interest payments on these loans (determined without regard to section 7872(d)(1)) would be \$9,000. The amount of imputed interest payment attributable to each loan after application of section 7872(d)(1) is computed as follows:

Loan	Imputed interest payments (before application of section 7872(d)(1))		Relative share of net investment income (imputed interest payment after application of section 7872(d)(1))
1	\$3,000	\$2,000	$(\$6,000 \times \$3,000/\$9,000)$
2	4,000	2,667	$(6,000 \times 4,000/9,000)$
3	2,000	1,333	$(6,000 \times 2,000/9,000)$
Total	\$9,000	\$6,000	

Consequently, the imputed interest payment to lender 1 cannot exceed \$2,000; the imputed interest payment to lender 2 cannot exceed \$2,667; and, the imputed interest payment to lender 3 cannot exceed \$1,333.