

## Prop. Reg. Section 1.7872-5(c)(3)

Exempted loans.

(a) In general –

- (1) General rule. Except as provided in paragraph (a)(2) of this section, notwithstanding any other provision of section 7872 and the regulations thereunder, section 7872 does not apply to the loans listed in paragraph (b) of this section because the interest arrangements do not have a significant effect on the Federal tax liability of the borrower or the lender.
- (2) No exemption for tax avoidance loans. If a taxpayer structures a transaction to be a loan described in paragraph (b) of this section and one of the principal purposes of so structuring the transaction is the avoidance of Federal tax, then the transaction will be recharacterized as a tax avoidance loan as defined in section 7872(c)(1)(D).

(b) List of exemptions. Except as provided in paragraph (a) of this section, the following transactions are exempt from section 7872:

- (1) Loans which are made available by the lender to the general public on the same terms and conditions and which are consistent with the lender's customary business practices;
- (2) Accounts or withdrawable shares with a bank (as defined in section 581), or an institution to which section 591 applies, or a credit union, made in the ordinary course of its business;
- (3) Acquisitions of publicly traded debt obligations for an amount equal to the public trading price at the time of acquisition;
- (4) Loans made by a life insurance company (as defined in section 816(a)), in the ordinary course of its business, to an insured, under a loan right contained in a life insurance policy and in which the cash surrender values are used as collateral for the loans;
- (5) Loans subsidized by the Federal, State (including the District of Columbia), or Municipal government (or any agency or instrumentality thereof), and which are made available under a program of general application to the public;
- (6) Employee-relocation loans that meet the requirements of paragraph (c)(1) of this section;
- (7) Obligations the interest on which is excluded from gross income under section 103;
- (8) Obligations of the United States government;

- (9) Loans to a charitable organization (described in section 170(c)), but only if at no time during the taxable year will the aggregate outstanding amount of loans by the lender to all such organizations exceed \$10,000;
- (10) Loans made to or from a foreign person that meet the requirements of paragraph (c)(2) of this section;
- (11) Loans made by a private foundation or other organization described in section 170(c), the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B);
- (12) Loans made prior to July 1, 1986, to the extent excepted from the application of section 482 for the 6-month (or longer) period referred to in § 1.482-2(a)(3);
- (13) For periods prior to July 1, 1986, all money, securities, and property received by a futures commission merchant or by a clearing organization (i) to margin, guarantee or secure contracts for future delivery on or subject to the rules of a qualified board or exchange (as defined in section 1256(g)(7)), or (ii) to purchase, margin, guarantee or secure options contracts traded on or subject to the rules of a qualified board or exchange, and all money accruing to account holders as the result of such futures and options contracts;
- (14) Loans where the taxpayer can show that the below market interest arrangements have no significant effect on any Federal tax liability of the lender or the borrower, as described in paragraph (c)(3) of this section; and
- (15) Loans, described in revenue rulings or revenue procedures issued under section 7872(g)(1)(C), if the Commissioner finds that the factors justifying an exemption for such loans are sufficiently similar to the factors justifying the exemptions contained in this section.

(c) Special rules –

(1) Employee-relocation loans –

- (i) Mortgage loans. In the case of a compensation-related loan to an employee, where such loan is secured by a mortgage on the new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee, acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:
  - (A) The loan is a demand loan or is a term loan the benefits of the interest arrangements of which are not transferable by the employee and are conditioned on the future performance of substantial services by the employee;
  - (B) The employee certifies to the employer that the employee reasonably expects to be entitled to and will itemize deductions for each year the loan is outstanding; and

(C) The loan agreement requires that the loan proceeds be used only to purchase the new principal residence of the employee.

(ii) Bridge loans. In the case of a compensation-related loan to an employee which is not described in paragraph (c)(1)(i) of this section, and which is used to purchase a new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The conditions contained in paragraphs (c)(1)(i)(A), (B), and (C) of this section;

(B) The loan agreement provides that the loan is payable in full within 15 days after the date of the sale of the employee's immediately former principal residence;

(C) The aggregate principal amount of all outstanding loans described in this paragraph (c)(1)(ii) to an employee is no greater than the employer's reasonable estimate of the amount of the equity of the employee and the employee's spouse in the employee's immediately former principal residence, and

(D) The employee's immediately former principal residence is not converted to business or investment use.

(2) Below-market loans involving foreign persons –

(i) Section 7872 shall not apply to a below-market loan (other than a compensation-related loan or a corporation-shareholder loan where the borrower is a shareholder that is not a C corporation as defined in section 1361(a)(2)) if the lender is a foreign person and the borrower is a U.S. person, unless the interest income imputed to the foreign lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(ii) Section 7872 shall not apply to a below-market loan where both the lender and the borrower are foreign persons unless the interest income imputed to the lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(iii) For purposes of this section, the term "foreign person" means any person that is not a U.S. person.



(3) Loans without significant tax effect. Whether a loan will be considered to be a loan the interest arrangements of which have a significant effect on any Federal tax liability of the

lander or the borrower will be determined according to all of the facts and circumstances. Among the factors to be considered are –

- (i) Whether items of income and deduction generated by the loan offset each other;
- (ii) The amount of such items;
- (iii) The cost to the taxpayer of complying with the provisions of section 7872 if such section were applied, and
- (iv) Any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.