

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-103694-99]

RIN 1545-AW75

Section 467 Rental Agreements Involving Payments of \$2,000,000 or Less

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations concerning section 467 rental agreements. The regulations remove the constant rental accrual exception for rental agreements involving payments of \$2,000,000 or less. The regulations affect taxpayers that are parties to a section 467 rental agreement entered into on or after July 19, 1999.

DATES: Written or electronically generated comments and requests for a public hearing must be received by August 16, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-103694-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-103694-99), 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 on the IRS Home

Page, or by submitting comments directly to

http://www.irs.ustreas.gov/tax_regs/regslst.html (the IRS Internet address).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Forest Boone, (202) 622-4960; concerning submissions of comments, Michael L. Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to section 467 of the Income Tax Regulations (26 CFR Part 1). Section 467 was added to the Internal Revenue Code by section 92(a) of the Tax Reform Act of 1984 (Public Law 98-369 (98 Stat. 609)). On June 3, 1996, the IRS and Treasury Department issued a notice of proposed rulemaking (61 FR 27834 [IA-292-84, 1996-2 C.B. 462]) relating to section 467. Comments responding to the notice were received, and a public hearing was held on September 25, 1996. After considering the comments received and the statements made at the public hearing, final regulations under section 467 have been completed and also appear elsewhere in this issue of the **Federal Register**. This regulation proposes to amend the section 467 regulations and, for purposes of the application of constant rental accrual, treat rental agreements involving payments of \$2,000,000 or less in the same manner as those agreements involving payments of more than \$2,000,000.

Explanation of Provisions

Under the section 467 final regulations, section 467 applies only in the case of rental agreements with increasing or decreasing rent or deferred or prepaid rent. However, section 467 is not applicable in the case of rental agreements involving payments and other consideration of \$250,000 or less. See section 467(d)(2).

The section 467 final regulations provide that if section 467 is applicable, the amount of fixed rent that must be taken into account by a lessor and lessee for a rental period is either the amount of fixed rent allocated to the period under the agreement, the proportional rental amount, or the constant rental amount (constant rental accrual). Constant rental accrual is to be used only where the section 467 rental agreement is a disqualified leaseback or long-term agreement. Under the section 467 final regulations, a rental agreement will not be a disqualified leaseback or long-term agreement, and, consequently, will not be subject to constant rental accrual, if it requires \$2,000,000 or less in rental payments and other consideration.

The IRS and Treasury Department have reconsidered the \$2,000,000 constant rental accrual exception and have determined that it should be eliminated from the section 467 final regulations. The original purpose of the \$2,000,000 exception was to simplify the section 467 rules for small businesses. Upon

further reflection, however, the IRS and Treasury Department believe that the \$2,000,000 exception inappropriately permits certain rental agreements to avoid the application of constant rental accrual, and that the inappropriate avoidance of constant rental accrual outweighs the need for simplification. Further, section 467(d)(2) provides an exception from section 467 for rental agreements with payments and other consideration of \$250,000 or less. However, because the \$2,000,000 constant rental accrual exception was included in the proposed regulations, the \$2,000,000 exception will continue to apply to agreements entered into on or before July 19, 1999.

Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of the regulations is Forest Boone, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in the development of the regulations.

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 continues to

read in part as follows:

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

Par 2. In §1.467-3, paragraph (b)(1) is revised to read as follows:

§1.467-3 Disqualified leasebacks and long-term agreements.

* * * * *

(b) Disqualified leaseback or long-term agreement--(1) In general. A leaseback (as defined in paragraph (b)(2) of this section) or a long-term agreement (as defined in paragraph (b)(3) of this section) is disqualified only if--

(i) A principal purpose for providing increasing or decreasing rent is the avoidance of Federal income tax (as described in paragraph (c) of this section); and

(ii) The Commissioner determines that, because of the tax avoidance purpose, the section 467 rental agreement should be treated as a disqualified leaseback or long-term agreement.

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Robert E. Wenzel

Deputy Commissioner of Internal Revenue