

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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LEGEND

Taxpayer =

B =

Dear :

This is in reply to Taxpayer's request for a private letter ruling that in determining the calculated interest under § 453(l)(3) of the Internal Revenue Code for an installment obligation, the Taxpayer will use an applicable Federal rate (AFR) determined separately for each payment due under the installment obligation rather than a single AFR based on the term of the obligation.

FACTS

Taxpayer develops, markets, sells, and manages timeshares and related products. Taxpayer generates most of its revenues from four primary sources, including selling timeshare interests, and financing consumer purchases of timeshare interests. Taxpayer sells timeshare interests for a fixed purchase price that is either paid in full at closing, or financed with a loan provided by Taxpayer. Financing typically involves a loan with a period of B years, with payments due on a monthly basis.

Taxpayer recognizes income associated with its financed timeshare sales using the installment method under § 453(l)(2)(B). In accordance with § 453(l)(3), Taxpayer increases its federal income tax liability each year a payment is received on the

installment obligation (other than the year of sale) by an amount of calculated interest. The amount of the calculated interest is determined based on the amount of tax due for the year that is attributable to the payments on the installment obligation received during the year from the date of sale to the date of each payment received, by using the applicable Federal rate (AFR) under § 1274 in effect at the time of the sale.

Taxpayer requests a ruling that in computing interest under § 453(l)(3), Taxpayer will use an AFR determined separately for each payment due under the installment obligation, based on the time period between the date of sale and the date of each payment.

LAW AND ANALYSIS

Section 453(a) of the Internal Revenue Code provides that, except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method.

Section 453(b)(1) defines the term “installment sale” to mean a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs.

Section 453(b)(2)(A) states that dealer dispositions do not qualify as installment sales. Dealer dispositions of real property are defined in § 453(l)(1)(B) as any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer’s trade or business. Section 453(l)(2)(B), which provides an exception to this rule specific to timeshares, excludes sales of timeshares from the definition of dealer dispositions if the taxpayer elects to apply § 453(l)(3). Timeshare sales include the sale of a timeshare right to use or a timeshare ownership interest in residential real property for not more than 6 weeks per year.

Section 453(l)(3)(A) requires that a taxpayer increase its tax liability for a year in which an installment payment is received by an amount of interest. Section 453(l)(3)(B) provides that the amount of interest referred to in subparagraph (A) for any taxable year shall be determined –

(I) on the amount of the tax for such taxable year which is attributable to the payments received during such taxable year on installment obligations to which this subsection applies,

(II) for the period beginning on the date of sale, and ending on the date such payment is received, and

(III) by using the applicable Federal rate under section 1274 (without regard to subsection (d)(2) thereof) in effect at the time of the sale compounded semiannually.

Section 1274(d)(1) provides that, for purposes of section 1274, the applicable Federal rate (“AFR”) in the case of a debt instrument with a term not over 3 years is the Federal

short-term rate; the AFR in the case of a debt instrument with a term over 3 years but not over 9 years is the Federal mid-term rate; and the AFR in the case of a debt instrument with a term over 9 years is the Federal long-term rate.

Section 1.1274-4(b) of the Income Tax Regulations provides that, except as otherwise provided in Section 1.1274-4, the AFR for a debt instrument is based on the term of the instrument (i.e., short-term, mid-term, or long-term). Section 1.1274-4(c) provides that if a debt instrument is an installment obligation (as defined in section 1.1273-1(e)(1)), the term of the instrument is the instrument's weighted average maturity (as defined in section 1.1273-1(e)(3)).

Section 1.1273-1(e)(1) states that an installment obligation is a debt instrument that provides for the payment of any amount other than qualified stated interest before maturity. For example, an installment obligation is a debt instrument that provides for one or more partial principal payments.

Section 1.1273-1(e)(3) states that the weighted average maturity of a debt instrument is the sum of the following amounts determined for each payment under the instrument (other than a payment of qualified stated interest): (i) the number of complete years from the issue date until the payment is made; multiplied by (ii) a fraction, the numerator of which is the amount of the payment and the denominator of which is the debt instrument's stated redemption price at maturity.

In determining the AFR to be used under § 453(l)(3)(B)(i)(III) to determine the amount of calculated interest for any taxable year, the seller must first determine the term of the installment obligation between the buyer and the seller. Here, the obligation between the buyer and seller is an installment obligation under § 1.1273-1(e)(1) because the obligation provides for partial principal payments before maturity. As a result, the weighted average maturity of such obligation must be determined under § 1.1273-1(e)(3). The AFR to be used under § 453(l)(3)(B)(i)(III) to calculate the amount of interest for any taxable year is determined under § 1274(d)(1) by treating such weighted average maturity as the term of the installment obligation.

CONCLUSION

Based strictly on the information submitted and representations made, we conclude that the AFR to be used under § 453(l)(3)(B)(i)(III) to calculate the amount of interest for a taxable year is determined under § 1274(d)(1) by treating such weighted average maturity as the term of the installment obligation.

This letter ruling is directed only to the taxpayer requesting it, and does not express or imply an opinion on the federal tax consequences of any aspect of this transaction other than that expressed in the preceding sentence. Section 6110(k)(3) provides that this letter ruling may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations that Taxpayer submitted under penalties of perjury. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

Taxpayer must attach to any income tax return to which it is relevant a copy of this letter or, if it files its returns electronically, include a statement providing the date and control number of this letter ruling.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Shareen S. Pflanz
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)