

CALCULATING IMPUTED INTEREST UNDER I.R.C. §§483 AND 1274 RELATIVE TO PEANUT QUOTA

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Golden Nutt's peanut quota was bought out by Farm Service Agency (FSA) under legislation that was signed by President Bush in May 2002. Golden can take installment payments over the term of the buyout (six years) or elect to take a lump sum payment. For tax management purposes Golden chose to receive his peanut quota buyout as equal installment payments.

Since Golden made this choice he must calculate imputed (unstated) interest when he receives his annual payments. Golden will receive a total of \$30,000 over 6 years of the installment period. In the initial year there will be no imputed interest, the five subsequent years must have the imputed interest calculated.

Calculating Imputed or Unstated Interest:

1. Under I.R.C. §1274 Golden must determine the Applicable Federal Rate (AFR). The AFR is calculated by determining the appropriate term (short, mid, or long) and applying the lowest rate from the month the contract begins and the 2 preceding months. Since the President signed the legislation in May, Golden looks to the rates for the mid-term rate (the contract is for 6 years and the federal mid-term rate is for a period greater than three years but less than nine years) in March, April and May. These rates were 4.52%, 4.65% and 4.99% respectively. Therefore, the rate Golden is to use is 4.52%¹. Treas. Reg §1.1274-4(a)(1)(ii)(A)
2. The second step is to calculate the net present value (NPV) of the income stream using the net present value formula: $V = \sum I / (1+i)^n$. Where V equals the NPV, I equals the annual income, *i* equals the interest rate, *n* equals the number of the year in the income stream.

$$V = [5,000/(1.0452)] + [5,000/(1.0924)] + [5,000/(1.1428)] + [5,000/(1.1934)] + [5,000/(1.2474)]$$
$$V = \$21,937.60$$

3. Therefore the imputed or unstated interest for the contract period is \$3,062.40 (\$25,000 - \$21,937.60).
4. Now amortize the interest over the contract period for the purposes of reporting the imputed or unstated interest under I.R.C. 1274 over the contract term.

¹ Applicable Federal Rates 2002

