

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

Number: **200943028**

Release Date: 10/23/2009

CC:ITA:B04: SSPflanz  
PRESP-136922-09

Third Party Communication: None  
Date of Communication: Not Applicable

UILC: 61.00-00, 7872.00-00, 7872.06-00

date: September 8, 2009

to: Roland Barral, Area Counsel  
(CC:LM:F)

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subject: SBA ARC Loan Program

This Chief Counsel Advice addresses an issue under your jurisdiction. This advice may not be used or cited as precedent.

ISSUE

Must a qualified small business borrower include in gross income under § 61 of the Internal Revenue Code interest on a loan that the Small Business Administration pays to a lender under the America's Recovery Capital Loan Program?

CONCLUSION

A qualified small business borrower does not include in gross income under § 61 any interest paid by the Small Business Administration to the lender and, correspondingly, has no interest deduction for this payment.

FACTS

Section 506 of the American Recovery and Reinvestment Act of 2009, P.L. 111-5, 123 Stat. 115 (the Act) authorizes the Small Business Administration (SBA) to carry out a temporary program to provide loans to help viable small businesses experiencing immediate financial hardship. Under the Act's authority, the SBA designed the

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America's Recovery Capital Loan Program (ARC Loan Program), allowing a qualified small business borrower (borrower) to receive a loan from an SBA-approved lender (lender) to make payments on qualifying small business loans. The ARC Loan Program extends through September 30, 2010, or until the appropriated funds run out, whichever comes first.

Under the terms of the ARC Loan Program, a borrower receives a loan of up to \$35,000 from a lender (ARC loan) to help make up to six months of principal and interest payments on qualifying small business loans. Some examples of qualifying small business loans include credit card obligations for the borrower's business, capital leases for major equipment and vehicles, and notes payable to suppliers or vendors. The proceeds from an ARC loan are disbursed over a six-month period and repayment of the loan principal is deferred for at least 12 months after the last disbursement of the proceeds. Repayment of an ARC loan may extend up to five years; however, the borrower is required to pay the principal over the repayment period.

Under the terms of an ARC loan, the SBA pays monthly interest to the lender, and provides a 100% guaranty of payment to the lender. See also section 506(f) of the Act. The borrower has no obligation to pay any interest on the loan. Finally, the Act and the ARC Loan Program prohibit the SBA and the lender of an ARC loan from charging any fees, including points, for ARC loans.

#### LAW AND ANALYSIS

Section 61 provides that gross income means all income from whatever source derived.

In general, § 7872 defines a below-market loan as any loan on which the interest rate charged is less than the applicable Federal rate (AFR). Section 7872(b) provides that the borrower of a below-market term loan is treated as having received from the lender, on the date the loan is made, cash in an amount equal to the excess of the amount loaned over the present value of all payments required under the loan (the "imputed transfer"). Section 7872(b) further provides that a below-market term loan is treated as having original issue discount ("OID") in an amount equal to the imputed transfer, which is in addition to any other OID on the loan determined without regard to § 7872(b).

Section 1.7872-5T(a)(1) of the temporary Income Tax Regulations provides that, notwithstanding any other provision of § 7872 and the regulations thereunder, § 7872 does not apply to the loans listed in § 1.7872-5T(b) because the interest arrangements of those loans do not have a significant effect on the federal tax liability of the borrower or the lender. Section 1.7872-5T(a)(2) provides, however, that if a taxpayer structures a transaction as a loan exempt under § 1.7872-5T(b) 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 under § 7872(c)(1)(D).

Section 1.7872-5T(b)(5) provides an exemption for loans that are subsidized by a

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federal, state, or municipal government (or any agency or instrumentality thereof), and that are made available under a program of general application to the public.

In authorizing the ARC loan program under § 506 of the Act, Congress does not impose on the borrower any obligation to pay interest on the ARC loans. It would be inconsistent with the statutory purpose of not imposing any interest obligation on the borrower to treat the SBA's payment of interest to the lender as resulting in gross income to the borrower under § 61. The borrower, however, is not entitled to an interest deduction for this loan.

In addition, § 7872 would not apply to ARC Loans. The ARC Loan Program was designed to carry out a temporary program to provide loans to help viable small businesses experiencing immediate financial hardship. As part of the ARC Loan Program, the SBA, rather than the borrower, is obligated to pay the interest on an ARC loan. A purpose of this interest arrangement is to alleviate the financial hardships of small businesses. The interest arrangements of the ARC loans are, therefore, not structured with a principal purpose of avoiding federal tax. Furthermore, even if the ARC loans were considered below-market loans within the meaning of § 7872(c), the loans would qualify for exemption under § 1.7872-5T(b).

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Please call \_\_\_\_\_ at (202) 622-4920 if you have any further questions.