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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9562]

RIN 1545-BH77

Conduit Financing Arrangements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations relating to conduit financing arrangements. The final regulations apply to multiple-party financing arrangements that are effected through disregarded entities, and are necessary in order to determine which of those arrangements should be recharacterized as a conduit financing arrangement.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Date: These regulations apply to payments made on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Quyen P. Huynh at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 10, 1995, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published final regulations under Treas. Reg. §1.881-3 relating

to conduit financing arrangements pursuant to the authority granted by section 7701(l) of the Internal Revenue Code (the conduit financing regulations). See TD 8611 (1995-37 IRB 20; 60 FR 40997). On December 22, 2008, the Treasury Department and the IRS published in the **Federal Register** (73 FR 246) a notice of proposed rulemaking (REG-113462-08) that proposed amending §1.881-3(a)(2)(i)(C) of the conduit financing regulations to treat an entity disregarded as an entity separate from its owner for U.S. tax purposes as a person for purposes of determining whether a conduit financing arrangement exists. The proposed regulations were proposed to be effective as of the date final regulations are published in the **Federal Register**. In addition, the preamble to the proposed regulations requested comments on whether “hybrid instruments” (instruments treated as debt for foreign law purposes and equity for U.S. purposes) should constitute *per se* “financing transactions” under §1.881-3(a)(2)(ii)(A) and part of a “financing arrangement” within the meaning of §1.881-3(a)(2)(i)(A), or whether, at a minimum, certain hybrid instruments should be so treated, depending on specific factors or criteria.

Only one comment letter responding to the notice of proposed rulemaking was received. No public hearing was requested or held. After consideration of the comment, this Treasury decision adopts the proposed regulations with minor edits to Example 3 and to clarify that the effective date of the final regulations also applies to new Example 3.

Explanation and Summary of Comment

The comment supported the proposed regulations and their interpretation of the term “person” to include a business entity that is disregarded as an entity separate from its single member owner under §301.7701-1 through §301.7701-3. The comment stated that to disregard an entity that is “regarded” for purposes of claiming treaty benefits would be inconsistent with the policy and purpose of the anti-conduit financing regulations.

As relates to hybrid instruments, the comment did not support either approach raised in the preamble to the proposed regulations, expressing both policy and administrative concerns with each. The comment stated that any specific abuses that the Treasury Department and the IRS were concerned about could be better addressed by a more targeted rule that described the specific transactions and limited the application of the regulations to those transactions. In light of the wide array of considerations raised, the Treasury Department and the IRS have decided to continue to study the area and not to provide any specific rules on hybrid instruments as part of this regulation package. Accordingly, these regulations are finalized without change, except to clarify that the effective date of the final regulations also applies to new Example 3 and to make minor edits to Example 3. The Treasury Department and the IRS continue to solicit comments on the treatment of hybrid instruments in financing transactions.

No inference should be drawn from any provision of these final regulations as to the treatment of financing transactions entered into with disregarded entities before the effective date of these final regulations or involving hybrid instruments.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Quyen P. Huynh of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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. Section 1.881-3 is amended by:

1. Removing the language “district director” throughout this section and adding “director of field operations” in its place.
2. Removing the language “§1.1441-3(j)” throughout this section and adding “§1.1441-3(g)” in its place.
3. Removing the language “§1.1441-7(d)” throughout this section and adding “§1.1441-7(f)” in its place.
4. In the last sentence of paragraph (a)(3)(ii)(B), removing the second “financed” and adding “financing” in its place.
5. Removing the parenthetical language “(or a similar interest in a partnership or trust)” in paragraphs (a)(2)(ii)(A)(2) and (a)(2)(ii)(B)(1) and adding “(or a similar interest in a partnership, trust, or other person)” in its place.
6. Adding a new paragraph (a)(2)(i)(C).

7. In paragraph (e), redesignating Examples 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, and 25 as Examples 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, and 26, respectively.

8. Adding a new Example 3 in paragraph (e).

9. Revising the paragraph heading and adding a new sentence at the end of paragraph (f).

The revisions and additions read as follows:

§1.881-3 Conduit financing arrangements.

* * * * *

(a) * * *

(2) * * *

(i) * * *

(C) Treatment of disregarded entities. For purposes of this section, the term person includes a business entity that is disregarded as an entity separate from its single member owner under §301.7701-1 through §301.7701-3.

* * * * *

(e) Examples. * * *

Example 3. Participation of a disregarded intermediate entity. The facts are the same as in Example 2, except that FS is an entity that is disregarded as an entity separate from its owner, FP, under §301.7701-3. Under paragraph (a)(2)(i)(C) of this section, FS is a person and, therefore, may itself be an intermediate entity that is linked by financing transactions to other persons in a financing arrangement. The DS note held by FS and the FS note held by FP are financing transactions within the meaning of paragraph (a)(2)(ii) of this section, and together constitute a financing arrangement within the meaning of paragraph (a)(2)(i) of this section.

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(f) Effective/applicability date. * * * Paragraph (a)(2)(i)(C) and Example 3 of paragraph (e) of this section apply to payments made on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].**

Steven T. Miller

Deputy Commissioner for Services and Enforcement.

Approved: November 29, 2011

Emily S. McMahon

Acting Assistant Secretary of the Treasury (Tax Policy).

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