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[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-130314-16

RIN 1545-BN68

Treatment of Certain Interests in Corporations as Stock or Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulation.

SUMMARY: The Department of the Treasury (Treasury Department) and the IRS are issuing temporary regulations that affect corporations and partnerships that issue purported indebtedness to related corporations or partnerships in the Rules and Regulations section of this issue of the **Federal Register**. The temporary regulations provide rules addressing the treatment of instruments issued by partnerships, consolidated groups, and certain transactions involving qualified cash-management arrangements. The text of the temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-130314-16), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand-delivered Monday through Friday between the hours

of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-130314-16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-130314-16).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Austin M. Diamond-Jones, (202) 317-5363, or Joshua G. Rabon, (202) 317-6937; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

## **Background**

The temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** contain rules under sections 385 and 752 of the Internal Revenue Code (Code) that establish requirements that ordinarily must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes. The text of the temporary regulations also serves as the text of the proposed regulations herein. The preamble to the temporary regulations explains the temporary regulations and the corresponding proposed regulations.

## **Special Analyses**

### **I. Regulatory Planning and Review**

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order

13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. Related rules in the final and temporary regulations under section 385 in TD 9790, published in the Rules and Regulations section of this issue of the **Federal Register**, have been designated a “significant regulatory action” under section 3(f) of Executive Order 12866. For a discussion of the economic impact of those final and temporary regulations, as well as these proposed regulations, please see the Regulatory Assessment accompanying TD 9790, published in the Rules and Regulations section of this issue of the **Federal Register**.

## II. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. Chapter 6), it is hereby certified that the final and temporary regulations in TD 9790, published in the Rules and Regulations section of this issue of the **Federal Register**, and accordingly, these proposed regulations proposed by cross-reference to the temporary regulations, will not have a significant economic impact on a substantial number of small entities.

Accordingly, a regulatory flexibility analysis is not required.

To facilitate the federal tax analysis of an interest in a corporation, taxpayers are required under existing law to substantiate their classification of an interest as stock or indebtedness for federal tax purposes. Section 1.385-3 provides that certain interests in a corporation that are held by a member of the corporation’s expanded group and that otherwise would be treated as indebtedness for federal tax purposes are treated as stock. Section 1.385-3T provides that for certain debt instruments issued by a controlled partnership, the holder is deemed to transfer all or a portion of the debt

instrument to the partner or partners in the partnership in exchange for stock in the partner or partners. Section 1.385-4T provides rules regarding the application of §§1.385-3 and 1.385-3T to members of a consolidated group. Sections 1.385-3 and 1.385-3T include multiple exceptions that limit their application. In particular, the threshold exception provides that the first \$50 million of expanded group debt instruments that otherwise would be reclassified as stock or deemed to be transferred to a partner in a controlled partnership under §1.385-3 or §1.385-3T will not be reclassified or deemed transferred under §1.385-3 or §1.385-3T. Although it is possible that the classification rules in §§1.385-3, 1.385-3T, and 1.385-4T could have an effect on small entities, the threshold exception of the first \$50 million of debt instruments otherwise subject to recharacterization or deemed transfer under §§1.385-3, 1.385-3T, and 1.385-4T makes it unlikely that a substantial number of small entities will be affected by §§1.385-3T or 1.385-4T.

Pursuant to section 7805(f) of the Code, the final regulations in TD 9790, published in the Rules and Regulations section of this issue of the **Federal Register**, have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. Comments were received requesting that the monetary thresholds contained in proposed §§1.385-2, 1.385-3, and 1.385-4 be increased in order to mitigate the impact on small businesses. These comments are addressed in Parts IV.B.1.d and V.E.4 of the Summary of Comments and Explanation of Revisions in the preamble of TD 9790, published in the Rules and Regulations section of this issue of the **Federal Register**. No comments

were received concerning the economic impact on small entities from the Small Business Administration.

### **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. Treasury and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits electronic or 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 authors of these regulations are Austin M. Diamond-Jones of the Office of Associate Chief Counsel (Corporate) and Joshua G. Rabon of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

### **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 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.385-4 also issued under 26 U.S.C. 385 and 1502.

Par. 2. Section 1.385-3 is amended by:

1. Revising paragraph (b)(3)(vii).
2. Revising paragraph (d)(4).
3. Revising paragraph (f).
4. Revising paragraphs (g)(5)-(8), (15)-(17), and (22)-(23).
5. Revising Example 12 through Example 19 in paragraph (h)(3).
6. Adding paragraph (k).

The revisions and additions read as follows:

§1.385-3 Transactions in which debt proceeds are distributed or that have a similar effect.

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(vii) [The text of the proposed amendment to §1.385-3(b)(3)(vii) is the same as the text of §1.385-3T(b)(3)(vii) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \* \*

(d) \* \* \*

(4) [The text of the proposed amendment to §1.385-3(d)(4) is the same as the text of §1.385-3T(d)(4) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \* \*

(f) [The text of the proposed amendment to §1.385-3(f) is the same as the text of §1.385-3T(f) published elsewhere in this issue of the **Federal Register**.]

(g) \* \* \*

(5) [The text of the proposed amendment to §1.385-3(g)(5) is the same as the text of §1.385-3T(g)(5) published elsewhere in this issue of the **Federal Register**.]

(6) [The text of the proposed amendment to §1.385-3(g)(6) is the same as the text of §1.385-3T(g)(6) published elsewhere in this issue of the **Federal Register**.]

(7) [The text of the proposed amendment to §1.385-3(g)(7) is the same as the text of §1.385-3T(g)(7) published elsewhere in this issue of the **Federal Register**.]

(8) [The text of the proposed amendment to §1.385-3(g)(8) is the same as the text of §1.385-3T(g)(8) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \* \*

(15) [The text of the proposed amendment to §1.385-3(g)(15) is the same as the text of §1.385-3T(g)(15) published elsewhere in this issue of the **Federal Register**.]

(16) [The text of the proposed amendment to §1.385-3(g)(16) is the same as the text of §1.385-3T(g)(16) published elsewhere in this issue of the **Federal Register**.]

(17) [The text of the proposed amendment to §1.385-3(g)(16) is the same as the text of §1.385-3T(g)(17) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \* \*

(22) [The text of the proposed amendment to §1.385-3(g)(22) is the same as the text of §1.385-3T(g)(22) published elsewhere in this issue of the **Federal Register**.]

(23) [The text of the proposed amendment to §1.385-3(g)(23) is the same as the text of §1.385-3T(g)(23) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \* \*

(h) \* \* \*

(3) \* \* \*

Example 12. [The text of the proposed amendment to §1.385-3(h)(3), Example 12 is the same as the text of §1.385-3T(h)(3), Example 12 published elsewhere in this issue of the **Federal Register.**]

Example 13. [The text of the proposed amendment to §1.385-3(h)(3), Example 13 is the same as the text of §1.385-3T(h)(3), Example 13 published elsewhere in this issue of the **Federal Register.**]

Example 14. [The text of the proposed amendment to §1.385-3(h)(3), Example 14 is the same as the text of §1.385-3T(h)(3), Example 14 published elsewhere in this issue of the **Federal Register.**]

Example 15. [The text of the proposed amendment to §1.385-3(h)(3), Example 15 is the same as the text of §1.385-3T(h)(3), Example 15 published elsewhere in this issue of the **Federal Register.**]

Example 16. [The text of the proposed amendment to §1.385-3(h)(3), Example 16 is the same as the text of §1.385-3T(h)(3), Example 16 published elsewhere in this issue of the **Federal Register.**]

Example 17. [The text of the proposed amendment to §1.385-3(h)(3), Example 17 is the same as the text of §1.385-3T(h)(3), Example 17 published elsewhere in this issue of the **Federal Register.**]

Example 18. [The text of the proposed amendment to §1.385-3(h)(3), Example 18 is the same as the text of §1.385-3T(h)(3), Example 18 published elsewhere in this issue of the **Federal Register.**]

Example 19. [The text of the proposed amendment to §1.385-3(h)(3), Example 19 is the same as the text of §1.385-3T(h)(3), Example 19 published elsewhere in this issue of the **Federal Register.**]

\* \* \* \* \*

(k) [The text of the proposed amendment to §1.385-3(k) is the same as the text of §1.385-3T(k) published elsewhere in this issue of the **Federal Register.**]

Par. 3. Section 1.385-4 is added to read as follows:

§1.385-4 Treatment of consolidated groups.

[The text of proposed §1.385-4 is the same as the text of §1.385-4T published elsewhere in this issue of the **Federal Register.**]

Par. 4. Section 1.752-2 is amended by:

1. Revising paragraph (c)(3).
2. Revising paragraph (l)(4).

The addition and revision read as follows

§1.752-2 Partner's share of recourse liabilities.

\* \* \* \* \*

(c) \* \* \*

(3) [The text of the proposed amendment to §1.752-2(c)(3) is the same as the text of §1.752-2T(c)(3) published elsewhere in this issue of the **Federal Register.**]

\* \* \* \* \*

(l) \* \* \*

(4) [The text of the proposed amendment to §1.752-2(l)(4) is the same as the text of §1.752-2T(l)(4) published elsewhere in this issue of the **Federal Register**.]

John Dalrymple

Deputy Commissioner for Services and Enforcement.

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