



[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9676]

RIN 1545-BJ59

Allocation and Apportionment of Interest Expense

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance concerning the allocation and apportionment of interest expense by corporations owning a 10 percent or greater interest in a partnership, as well as the allocation and apportionment of interest expense using the fair market value method. These regulations also update the interest allocation regulations to conform to the statutory changes made by section 216 of the legislation commonly referred to as the Education Jobs and Medicaid Assistance Act (EJMAA), enacted on August 10, 2010, affecting the affiliation of certain foreign corporations for purposes of section 864(e). These regulations affect taxpayers that allocate and apportion interest expense.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF**

**PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §§1.861-9(k) and 1.861-11(d)(6)(ii).

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Parry, (202) 317-6936 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### **Background and Explanation of Provisions**

On September 14, 1988, a notice of proposed rulemaking by cross-reference to temporary regulations and temporary regulations (TD 8228) under section 861 of the Internal Revenue Code (Code) (the 1988 temporary regulations) were published in the **Federal Register** at [53 FR 35525] and [53 FR 35467], respectively. On January 17, 2012, a notice of proposed rulemaking by cross-reference to temporary regulations (REG-113903-10) and temporary regulations (the 2012 temporary regulations) (TD 9571) which revised, in part, the 1988 temporary regulations, were published in the **Federal Register** at [77 FR 2240] and [77 FR 2225], respectively. Corrections to the 2012 temporary regulations were published on February 21, 2012, in the **Federal Register** at [77 FR 9844]. No written comments were received on the 2012 temporary regulations or on the portion of the 1988 temporary regulations included in this regulation. A public hearing was not requested and none was held. This Treasury decision adopts the proposed regulations published in connection with the 2012 temporary regulations, as well as the portions of §1.861-9T(e)(2) and (3) of the 1988 temporary regulations that were not amended by the 2012 temporary regulations, with no substantive change.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive

Order 13653. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), 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 Jeffrey L. Parry of the Office of 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 1.861-9 is amended by

1. Revising paragraphs (a), (b), (c), (d), (e), (f)(1), (f)(2), (f)(3)(i), (f)(5), (g), (h)(1), (h)(2), (h)(3), and (h)(4); and

2. Adding five new sentences to the end of paragraph (k).

The revisions and addition read as follows:

§1.861-9 Allocation and apportionment of interest expense

(a) through (e)(1) [Reserved]. For further guidance, see §1.861-9T(a) through (e)(1).

(2) Corporate partners whose interest in the partnership is 10 percent or more. A corporate partner shall apportion its interest expense, including the partner's distributive share of partnership interest expense, by reference to the partner's assets, including the partner's pro rata share of partnership assets, under the rules of paragraph (f) of this section if the corporate partner's direct and indirect interest in the partnership (as determined under the attribution rules of section 318) is 10 percent or more. A corporation using the tax book value method or alternative tax book value method of apportionment shall use the partnership's inside basis in its assets, including adjustments under sections 734(b) and 743(b), if any, and adjusted to the extent required under §1.861-10T(d)(2). A corporation using the fair market value method of apportionment shall use the fair market value of the partnership's assets, adjusted to the extent required under §1.861-10T(d)(2).

(3) Individual partners who are general partners or who are limited partners with an interest in the partnership of 10 percent or more. An individual partner is subject to the rules of this paragraph (e)(3) if either the individual is a general partner or the individual's direct and indirect interest (as determined under the attribution rules of section 318) in the partnership is 10 percent or more. The individual shall first classify his or her distributive share of partnership interest expense as interest incurred in the active conduct of a trade or business, as passive activity interest, or as investment interest under regulations issued under sections 163 and 469. The individual must then

apportion his or her interest expense, including the partner's distributive share of partnership interest expense, under the rules of paragraph (d) of this section. Each such individual partner shall take into account his or her distributive share of the partnership gross income or pro rata share of the partnership assets in applying such rules. An individual using the tax book value or alternative tax book value method of apportionment shall use the partnership's inside basis in its assets, including adjustments under sections 734(b) and 743(b), if any, and adjusted to the extent required under §1.861-10T(d)(2). An individual using the fair market value method of apportionment shall use the fair market value of the partnership's assets, adjusted to the extent required under §1.861-10(d)(2).

(e)(4) through (f)(3)(i) [Reserved]. For further guidance, see §1.861-9T(e)(4) through (f)(3)(i).

\* \* \* \* \*

(f)(5) through (h)(3) [Reserved]. For further guidance, see §1.861-9T(f)(5) through (h)(3).

(h)(4) Valuing related party debt and stock in related persons – (i) Related party debt. For purposes of this section, the value of a debt obligation of a related person held by the taxpayer or another person related to the taxpayer equals the amount of the liability of the obligor related person.

(ii) Stock in related persons. The value of stock in a related person held by the taxpayer or by another person related to the taxpayer equals the sum of the following amounts reduced by the taxpayer's pro rata share of liabilities of such related person:

(A) The portion of the value of intangible assets of the taxpayer and related persons that is apportioned to such related person under §1.861-9T(h)(2);

(B) The taxpayer's pro rata share of tangible assets held by the related person (as determined under §1.861-9T(h)(1)(ii));

(C) The taxpayer's pro rata share of debt obligations of any related person held by the related person (as valued under paragraph (h)(4)(i) of this section); and

(D) The total value of stock in all related persons held by the related person as determined under this paragraph (h)(4).

(iii) Example. (A) Facts. USP, a domestic corporation, wholly owns CFC1 and owns 80% of CFC2, both foreign corporations. The aggregate trading value of USP's stock traded on established securities markets at the end of Year 1 is \$700 and the amount of USP's liabilities to unrelated persons at the end of Year 1 is \$400. Neither CFC1 nor CFC2 has liabilities to unrelated persons at the end of Year 1. USP owns plant and equipment valued at \$500, CFC1 owns plant and equipment valued at \$400, and CFC2 owns plant and equipment valued at \$250. The value of these assets has been determined using generally accepted valuation techniques, as required by §1.861-9(h)(1)(ii). There is an outstanding loan from CFC2 to CFC1 in an amount of \$100. There is also an outstanding loan from USP to CFC1 in an amount of \$200.

(B) Valuation of group assets. Pursuant to §1.861-9T(h)(1)(i), the aggregate value of USP's assets is \$1100 (the \$700 trading value of USP's stock increased by \$400 of USP's liabilities to unrelated persons).

(C) Valuation of tangible assets. Pursuant to §1.861-9T(h)(1)(ii), the value of USP's tangible assets and pro rata share of assets held by CFC1 and CFC2 is \$1100 (the plant and equipment held directly by USP, valued at \$500, plus USP's 100% pro rata share of the plant and equipment held by CFC1 valued at \$400 and USP's 80% pro rata share of the plant and equipment held by CFC 2 valued at \$200 (80% of \$250)).

(D) Computation of intangible asset value. Pursuant to §1.861-9T(h)(1)(iii), the value of the intangible assets of USP, CFC1, and CFC2 is \$0 (total aggregate group asset value (\$1100) determined in paragraph (B) less total tangible asset value (\$1100) determined in paragraph (C)). Because the intangible asset value is zero, the provisions of §1.861-9T(h)(2) and (3) relating to the apportionment and characterization of intangible assets do not apply.

(E) Valuing related party debt obligations. Pursuant to §1.861-9(h)(4)(i), the value of the debt obligation of CFC1 held by CFC2 is equal to the amount of the liability,

\$100. The value of the debt obligation of CFC1 held by USP is equal to the amount of the liability, \$200.

(F) Valuing the stock of CFC1 and CFC2. Pursuant to §1.861-9(h)(4)(ii), the value of the stock of CFC2 held by USP is \$280 (USP's 80% pro rata share of tangible assets of CFC2 included in paragraph (C) (\$200) plus USP's 80% pro rata share of the debt obligation of CFC1 held by CFC2 valued in paragraph (E) (\$80). The value of the stock of CFC1 held by USP is \$100 (USP's 100% pro rata share of tangible assets of CFC1 included in paragraph (C) (\$400) less USP's 100% pro rata share of the liabilities of CFC1 to USP and CFC2 (\$300)).

\* \* \* \* \*

(k) \* \* \* Paragraphs (e)(2), (e)(3) and (h)(4) apply to taxable years beginning on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See 26 CFR 1.861-9T(e)(2) and (3) (revised as of April 1, 2014) for rules applicable to taxable years beginning after January 17, 2012, and before **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See 26 CFR 1.861-9T(e)(2) and (3) (revised as of April 1, 2011) for rules applicable to taxable years beginning on or before January 17, 2012. See 26 CFR 1.861-9T(h)(4) (revised as of April 1, 2014) for rules applicable to taxable years ending on or after January 17, 2012, and beginning before **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See 26 CFR 1.861-9T(h)(4) (revised as of April 1, 2011) for rules applicable to taxable years ending before January 17, 2012.

Par. 3. Section 1.861-9T is amended by:

1. Revising paragraphs (e)(2), (e)(3), and (h)(4);
2. Removing the four sentences before the last sentence of paragraph (k); and
3. Removing paragraph (l).

The revisions read as follows:

**§1.861-9T Allocation and apportionment of interest expense (temporary).**

\* \* \* \* \*

(e)(2) through (e)(3) [Reserved]. For further guidance see §1.861-9(e)(2) through (e)(3).

\* \* \* \* \*

(h) \* \* \*

(4) [Reserved]. For further guidance see §1.861-9(h)(4).

\* \* \* \* \*

Par. 4. In §1.861-11, paragraphs (d)(3), (d)(4), (d)(5), and (d)(6) are revised to read as follows:

§1.861-11 Special rules for allocating and apportioning interest expense of an affiliated group of corporations.

\* \* \* \* \*

(d)(3) through (6)(i) [Reserved]. For further guidance see §1.861-11T(d)(3) through (6)(i).

(ii) Any foreign corporation if more than 50 percent of the gross income of such foreign corporation for the taxable year is effectively connected with the conduct of a trade or business within the United States and at least 80 percent of either the vote or value of all outstanding stock of such foreign corporation is owned directly or indirectly by members of the affiliated group (determined with regard to this sentence). This paragraph (d)(6)(ii) applies to taxable years beginning on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See 26 CFR 1.861-11T(d)(6)(ii) (revised as of April 1, 2014) for rules applicable to taxable years beginning after August 10, 2010, and before **[INSERT DATE OF PUBLICATION OF**



**THIS DOCUMENT IN THE FEDERAL REGISTER**. See 26 CFR 1.861-11T(d)(6)(ii)

(revised as of April 1, 2010) for rules applicable to taxable years beginning on or before August 10, 2010.

\* \* \* \* \*

Par. 5. Sec 1.861-11T is amended by:

1. Revising paragraph (d)(6)(ii);
2. Removing the last two sentences of paragraph (h); and
3. Removing paragraph (i).

The revision reads as follows:

1.861-11T. Special rules for allocating and apportioning interest expense of an affiliated group of corporations (temporary).

\* \* \* \* \*

(d) \* \* \*

(6) \* \* \*

(ii) [Reserved]. For further guidance see §1.861-11(d)(6)(ii).

\* \* \* \* \*

John Dalrymple

Deputy Commissioner for Services and Enforcement.

Approved: June 17, 2014

Mark J. Mazur

Assistant Secretary of the Treasury (Tax Policy).

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