



[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9880]

RIN 1545-BO02

Removal of Section 385 Documentation Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document removes final regulations setting forth minimum documentation 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. This document also adopts conforming amendments to other final regulations to reflect the removal of the documentation regulations. The final regulations removed or amended by this document generally affect corporations that issue purported indebtedness to related corporations or partnerships.

**DATES:** These regulations are effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** Austin Diamond-Jones, (202) 317-5363 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

## **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act (44 U.S.C. 3501-3521), approval for the information collection included in these regulations had been requested under control number 1545-2267. Because of the removal of the final documentation regulations, the information burden has been removed and control number 1545-2267 is no longer needed.

## **Background**

### **I. Overview**

Section 385(a) of the Internal Revenue Code (Code) authorizes the Secretary to “prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated for purposes of [the Code] as stock or indebtedness (or as in part stock and in part indebtedness).” Section 385(b) requires such regulations to “set forth factors which are to be taken into account in determining with respect to a particular factual situation whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists.” Section 385(b) also enumerates a nonexclusive list of factors potentially to be included in those regulations.

On October 21, 2016, the Department of the Treasury (Treasury Department) and the IRS published final and temporary regulations (T.D. 9790) under section 385 in the **Federal Register** (81 FR 72858). The final and temporary regulations under section 385 (Section 385 Regulations) include rules set forth in §1.385-2, which establish minimum documentation requirements that ordinarily must be satisfied in order for purported debt obligations among related parties to be treated as debt for Federal tax purposes (Documentation Regulations). The Section 385 Regulations also include

§§1.385-3, 1.385-3T, and 1.385-4T, which treat as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result (Distribution Regulations).

The Documentation Regulations, as proposed, would have been applicable with respect to interests issued or deemed issued on or after the date of finalization.

However, commenters expressed concern that, if the Documentation Regulations were to be applicable as of that date, taxpayers would lack adequate time to prepare for compliance with the requirements set forth in those regulations. To assist taxpayers in their preparation for the Documentation Regulations, the Treasury Department and the IRS made the regulations applicable with respect to interests issued or deemed issued after January 1, 2018. See §§1.385-1(f), 1.385-2(d)(2)(iii), and 1.385-2(i).

## II. Executive Order 13789

Executive Order 13789 (E.O. 13789), issued on April 21, 2017, instructed the Secretary to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the IRS. E.O. 13789 further instructed the Secretary to submit to the President within 60 days a report (First Report) that identifies regulations that meet these criteria. Notice 2017-38 (2017-30 I.R.B. 147 (July 24, 2017)) included the Section 385 Regulations in a list of eight regulations identified by the Secretary in the First Report as meeting at least one of the first two criteria specified in E.O. 13789. In addition, E.O. 13789 instructed the Secretary to submit to the

President a second report (Second Report) that recommended specific actions to mitigate the burden imposed by regulations identified in the First Report.

### III. Additional Delay in Application of Documentation Regulations

As noted in Part I of this Background section, the Treasury Department and the IRS had originally delayed the applicability date of the Documentation Regulations to help taxpayers prepare for compliance with those rules. Taxpayers, however, continued to express concern regarding the timing and potential application of the Documentation Regulations. Based on those continued concerns, and in light of the contemplated additional action regarding the Section 385 Regulations that resulted from E.O. 13789 review, the Treasury Department and the IRS determined that a further delay in the application of the Documentation Regulations would be appropriate. Accordingly, in Notice 2017-36 (2017-33 I.R.B. 208 (August 14, 2017)), the Treasury Department and the IRS announced their intent to amend the Documentation Regulations to delay the applicability of the regulations for 12 months, making the regulations applicable only to interests issued or deemed issued on or after January 1, 2019.

### IV. Proposed Removal of Documentation Regulations

The Second Report announced that the Treasury Department and the IRS were considering a proposal to revoke the finalized Documentation Regulations. See Executive Order 13789—Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, 82 FR 48013, 48016 (October 16, 2017). On September 24, 2018, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-130244-17) in the **Federal Register** (83 FR 48265) that proposed removing the Documentation Regulations and adopting conforming amendments to other final

regulations to reflect the removal of the Documentation Regulations (Proposed Regulations). The preamble to the Proposed Regulations provided that “taxpayers may rely on these proposed regulations, in their entirety, until the date a Treasury decision adopting these regulations as final regulations is published in the Federal Register” (Reliance Provision). Proposed Regulations, 83 FR at 48267.

### **Summary of Comments**

The Treasury Department and the IRS received three written comments regarding the Proposed Regulations. Two of the comments supported removal of the Documentation Regulations, while one comment opposed removal. In connection with the Proposed Regulations, the Treasury Department and the IRS also received a written comment addressing solely the Distribution Regulations.

The single commenter that opposed removal of the Documentation Regulations argued that the Proposed Regulations would hamper the ability of the IRS to counter earnings stripping, and result in significant decreases in Federal revenue. In addition, the commenter asserted that the removal likely would reduce the overall perceived legitimacy of the U.S. tax system, and consequently reduce voluntary compliance. The commenter further argued that removal of the Documentation Regulations would prove unnecessary because of (i) the delayed applicability date provided by Notice 2017-36 and (ii) substantial, taxpayer-favorable modifications included in the finalized Documentation Regulations.

The two commenters that supported removal of the Documentation Regulations contended that the regulations fail to balance appropriately (i) the burdens imposed on taxpayers with (ii) the expected benefits to the Federal government described in the

preceding paragraph. Both commenters expressed their appreciation for the Reliance Provision, and emphasized that application of the Documentation Regulations would have imposed onerous compliance burdens and costs on taxpayers. One commenter also asserted that the Reliance Provision appropriately reduced administrative burdens on the IRS.

The Treasury Department and the IRS have considered each of the competing arguments and concerns set forth by the commenters and have determined that the burdens imposed on taxpayers by the Documentation Regulations outweigh the regulations' intended benefits. As a result, this document adopts the Proposed Regulations with no change as final regulations. The Treasury Department and the IRS, however, continue to consider the issues addressed by the Documentation Regulations.

After this further review, the Treasury Department and the IRS may propose a modified version of the Documentation Regulations. In any modified version, the Treasury Department and the IRS would substantially simplify and streamline the proposal to minimize taxpayer burdens, while ensuring the collection of sufficient documentation and other information necessary for tax administration purposes. The Treasury Department and the IRS welcome comments regarding approaches that would most effectively achieve that balance. Any modified version of the Documentation Regulations would be proposed with a prospective effective date to allow sufficient lead-time for taxpayers to design and implement systems to comply with those regulations.

## **Effective Date**

The removal of §1.385-2 and the conforming modifications are effective as of  
**[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

## **Statement of Availability of IRS Documents**

IRS Notices cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

## **Special Analyses**

### **I. Regulatory Planning and Review – Economic Analysis**

Executive Order 13777 directs agencies to alleviate unnecessary regulatory burdens placed on the American people by managing the costs associated with the governmental imposition of private expenditures required to comply with Federal regulations. Executive Orders 13771, 13563, and 12866 direct agencies to prudently manage the cost of planned regulations by assessing 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.

The final regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. OMB has determined that the final regulations are not a

significant regulatory action. This final rule is an Executive Order 13771 deregulatory action.

#### A. Background

On October 21, 2016, the Treasury Department and the IRS published final and temporary regulations (T.D. 9790) under section 385 in the **Federal Register** (81 FR 72858). The final and temporary regulations under section 385 include rules set forth in §1.385-2, which establish minimum documentation requirements that ordinarily must be satisfied in order for purported debt obligations among related parties to be treated as debt for Federal tax purposes (that is, the Documentation Regulations).

These final regulations withdraw the Documentation Regulations, and thereby remove the requirements set forth in those regulations on taxpayers with respect to certain transactions related to debt issuance. If applicable, the Documentation Regulations would have prescribed the nature of the documentation necessary to substantiate the Federal income tax treatment of related-party interests as indebtedness, including documentation of factors analogous to those found in third-party loan agreements. In general, to comply with the Documentation Regulations, taxpayers would have needed to provide or otherwise establish the following: (1) evidence of an unconditional and binding obligation to make interest and principal payments on certain fixed dates; (2) that the holder of the loan had the rights of a creditor, including rights superior to shareholders in the case of dissolution; (3) a reasonable expectation of the borrower's ability to repay the loan; and (4) evidence of conduct consistent with a debtor-creditor relationship. The Documentation Regulations would have applied to relevant intercompany debt issued by U.S. borrowers beginning



in 2019, and would have required that the taxpayer's documentation for a given tax year be prepared by the time the borrower's Federal income tax return is filed.

Since the issuance of the Documentation Regulations, Congress enacted the Tax Cuts and Jobs Act, Public Law 115-97, 131 Stat. 2054 (2017) (TCJA). While the final regulations do not implement any provisions of the TCJA, the final regulations would interact with the TCJA. There are several provisions of the TCJA that reduced the tax advantages of conducting activity as part of a foreign controlled domestic corporation (FCDC) rather than in a domestically controlled company (DCC), and thus may affect the economic efficiency of the Documentation Regulations and, analogously, the removal of those regulations. First, for taxable years beginning after December 31, 2017, the TCJA reduced the statutory corporate tax rate from 35 percent to 21 percent, which lowers the effective tax rate for DCCs more than for FCDCs. Second, the ability of FCDCs to strip earnings out of the United States through the use of deductions for interest expense was significantly reduced by the TCJA through amendments to section 163(j) of the Internal Revenue Code. See section 13301(a) of the TCJA, 131 Stat. 2054, 2117-21. Specifically, the TCJA amendments to section 163(j) (1) eliminated the debt-equity ratio safe harbor, (2) reduced the maximum net interest deductions' share of adjusted taxable income from 50 percent to 30 percent, (3) limited all, rather than just related-party, interest deductions, and (4) eliminated the carryforward of excess limitation under pre-TCJA section 163(j). The TCJA's Base Erosion Anti-abuse Tax (BEAT) further reduces the tax advantage to deducting interest expense. See section 14401(a) of the TCJA, 131 Stat. 2054, 2226-32. Thus, the benefits of the

Documentation Regulations in reducing foreign acquisitions of U.S. assets and interest stripping were reduced by the TCJA.

#### B. Need for the final regulations

These final regulations implement the fifth deregulatory action identified for further consideration in the Second Report issued pursuant to E.O. 13789. Accordingly, the final regulations are needed to remove the Documentation Regulations.

#### C. Overview of the final regulations

These final regulations remove the Documentation Regulations, which set forth minimum documentation 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. In addition, the final regulations adopt conforming amendments to other final regulations to reflect the removal of the Documentation Regulations.

#### D. Economic analysis

##### 1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of these final regulations compared to a no-action baseline that reflects anticipated Federal income tax-related behavior in the absence of these final regulations.

##### 2. Summary of economic effects

These final regulations provide compliance cost savings for some taxpayers by eliminating the need to document relevant transactions in a prescribed manner. The behavior of taxpayers that nevertheless continue to document such transactions would not be changed to any measurable degree. While the removal of the Documentation Regulations may lead to an increase in investment in the United States, this effect is

likely to be small given that a body of other regulations continue to cover the terms of that investment. The final regulations may increase costs of the IRS in administering the Distribution Regulations and potentially lead to more noncompliance by some taxpayers.

An analysis discussing the anticipated economic effects of these regulations was included in the preamble to the Proposed Regulations. See Proposed Regulations, 83 FR at 48267-69. The Treasury Department and the IRS received no substantive comments regarding that analysis in response to the Proposed Regulations. The analysis included herein presents the analysis set forth in those Proposed Regulations.

### 3. Number of affected taxpayers

The Treasury Department and the IRS project that approximately 6,300 large C corporations are likely to be affected by these regulations. This estimate is based on the number of corporations that have sufficient assets (\$100 million) or revenue (\$50 million) or are publicly traded such that they would have been required to document the relevant transactions.

### 4. Monetized estimates of compliance burden effects from Documentation Regulations

The Treasury Department and the IRS estimate that removal of the Documentation Regulations will reduce taxpayer compliance costs by \$924 million over the period 2019-2028 (undiscounted nominal total). The net present value of the compliance cost savings is \$773 million and \$685 million (\$2018) using real discount rates of 3 percent and 7 percent, respectively. These amounts are \$90.6 million and \$97.5 million on an annualized basis, again based on 3 percent and 7 percent real rates, respectively. See below the “Change in Annual Compliance Costs” table.

These estimates include an ongoing reduction in compliance costs and a reduction in the start-up cost equal to four times the annual ongoing compliance cost savings. In addition, the analysis includes a sensitivity analysis in which the compliance costs are estimated for a 90-percent interval around our best estimate. First, the distributional characteristics of critical parameters used to produce the estimate are evaluated. Then, Monte Carlo simulations are used to vary the parameter values. Finally, alternative high and low estimates are computed based on parameter values at either end of the 90-percent range.

**Table. Change in Annual Compliance Costs**

<b>Estimated change in annual compliance costs (annualized value, \$2018 million)</b>	<b>Fiscal Years 2019 to 2028 (3% real discount rate)</b>	<b>Fiscal Years 2019 to 2028 (7% real discount rate)</b>
Central estimate	-\$90.6	-\$97.5
High estimate	-\$113.3	-\$121.9
Low estimate	-\$68.0	-\$73.1
<u>Technical note:</u> In this rulemaking, the Treasury Department made technical adjustments relative to the Documentation Regulations in calculating the annualized compliance cost estimates. The cost stream in this rulemaking is in 2018 dollars, reflects a two-year delay in effective date (relative to the previous estimates), and applies real discount rates of 3 percent and 7 percent. Technical adjustments account for part of the difference in the estimates between the rulemakings.		

## 5. Higher tax administrative costs for the IRS

The reduced loan documentation required of large corporations as a result of the removal of the Documentation Regulations will reduce the ability of the IRS to more effectively administer the tax laws by making it more difficult for the IRS to evaluate whether purported loans are properly treated as debt for Federal tax purposes. This will

raise the cost of auditing and evaluating the tax returns of companies engaged in these transactions.

## 6. Other economic effects

### a. Reduced tax compliance

As a result of the final regulations, taxpayers will not be required to comply with the Documentation Regulations. Therefore, such taxpayers will not need to satisfy the documentation requirements with respect to relevant transactions formerly addressed by the Documentation Regulations. That lack of documentation likely will slightly reduce voluntary compliance by taxpayers to report accurately the Federal income tax consequences of such transactions. The resulting expected revenue reduction is \$407 million over the period 2019 to 2028 (undiscounted nominal total). The annualized value of the revenue reduction is \$35.4 million and \$34.5 million (\$2018) using real discount rates of 3 percent and 7 percent, respectively. The revenue effects were estimated using the methodology described in the preamble to the Section 385 Regulations, although the estimate presented herein covers 2019 to 2028 and reflects factors that changed as a result of the TCJA as well as other technical adjustments.

### b. Efficiency and growth effects

The removal of the Documentation Regulations will increase, to some extent, the tax advantage some foreign owners have over some domestic owners of U.S. assets, and consequently may increase the propensity for foreign acquisitions and ownership of U.S. assets that are motivated by tax considerations rather than economics. By increasing the ability to undertake tax-motivated acquisitions or ownership structures, removal of the Documentation Regulations may slightly reduce the incentive for assets

to be owned or managed by those most capable of putting the assets to their highest-valued use. Moreover, removal of the Documentation Regulations may put purely domestic U.S. firms on less even tax footing than their foreign-owned competitors operating in the United States.

On the other hand, removal of the Documentation Regulations may slightly reduce the effective tax rate and compliance costs on investment in the United States. While the magnitude of this reduction is small, to the extent that the reduction increases new capital investment in the United States its effects would be efficiency enhancing.

## II. Regulatory Flexibility Act

As described in more detail in this section, pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), the Treasury Department and the IRS hereby certify that these final regulations will not have a significant economic impact on a substantial number of small entities.

The Documentation Regulations, as finalized, were made applicable with respect to interests issued or deemed issued on or after January 1, 2018. See Background section, part I. In Notice 2017-36, the Treasury Department and the IRS further delayed the applicability of the Documentation Regulations by making the regulations applicable only to interests issued or deemed issued on or after January 1, 2019. See Background section, part III. Because of the Reliance Provision, the Documentation Regulations are not applicable to any interests issued by any taxpayer, unless such taxpayer chooses to apply the regulations despite the Reliance Provision. See Background section, part IV.

The Documentation Regulations apply to large corporate groups (specifically, those that are publicly traded, or have assets exceeding \$100 million or annual total revenue exceeding \$50 million in its expanded group), thus limiting the scope of small entities affected. The Documentation Regulations apply to financial institutions, which are considered small entities under the Regulatory Flexibility Act if they have less than \$550 million in assets. See 13 CFR 121.201. The Treasury Department and the IRS believe that the Documentation Regulations do not affect a substantial number of small entities other than small financial institutions. Even if the Documentation Regulations affected a substantial number of small entities in that sector, the economic impact of this rule would be minimal because the final regulations adopt the Proposed Regulations, which remove the Documentation Regulations and permit taxpayers not to apply such regulations until adoption of these final regulations. Accordingly, this final rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business and no comments were received.

### III. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that

threshold is approximately \$164 million. This final rule does not include any mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### IV. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial, direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

#### **Drafting Information**

The principal author of the final regulations is Austin Diamond-Jones, Office of the Associate Chief Counsel (Corporate). 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.

#### **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 is amended by removing the sectional authority for §1.385-2 to read, in part, as follows:



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

Par. 2. Section 1.385-1 is amended by:

1. Revising paragraph (a), the last sentence of paragraph (c), the last sentence of paragraph (c)(4)(iv), paragraph (d)(1)(i), the first sentence of paragraph (d)(1)(ii), and paragraphs (d)(1)(iii) and (d)(1)(iv)(A); and
2. Removing and reserving paragraph (d)(2)(i).

The revisions read as follows:

§1.385-1 General provisions.

(a) Overview of section 385 regulations. This section and §§1.385-3 through 1.385-4T (collectively, the section 385 regulations) provide rules under section 385 to determine the treatment of an interest in a corporation as stock or indebtedness (or as in part stock and in part indebtedness) in particular factual situations. Paragraph (b) of this section provides the general rule for determining the treatment of an interest based on provisions of the Internal Revenue Code and on common law, including the factors prescribed under common law. Paragraphs (c), (d), and (e) of this section provide definitions and rules of general application for purposes of the section 385 regulations. Section 1.385-3 sets forth additional factors that, when present, control the determination of whether an interest in a corporation that is held by a member of the corporation's expanded group is treated (in whole or in part) as stock or indebtedness.

\* \* \* \* \*

(c) \* \* \* For additional definitions that apply for purposes of their respective sections, see §§1.385-3(g) and 1.385-4T(e).

\* \* \* \* \*

(4) \* \* \*

(iv) \* \* \* For purposes of the section 385 regulations, a corporation is a member of an expanded group if it is described in this paragraph (c)(4)(iv) immediately before the relevant time for determining membership (for example, immediately before the issuance of a debt instrument (as defined in §1.385-3(g)(4)) or immediately before a distribution or acquisition that may be subject to §1.385-3(b)(2) or (3)).

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(i) In general. If a debt instrument (as defined in §1.385-3(g)(4)) is deemed to be exchanged under the section 385 regulations, in whole or in part, for stock, the holder is treated for all Federal tax purposes as having realized an amount equal to the holder's adjusted basis in that portion of the debt instrument as of the date of the deemed exchange (and as having basis in the stock deemed to be received equal to that amount), and, except as provided in paragraph (d)(1)(iv)(B) of this section, the issuer is treated for all Federal tax purposes as having retired that portion of the debt instrument for an amount equal to its adjusted issue price as of the date of the deemed exchange. In addition, neither party accounts for any accrued but unpaid qualified stated interest on the debt instrument or any foreign exchange gain or loss with respect to that accrued but unpaid qualified stated interest (if any) as of the deemed exchange. This paragraph (d)(1)(i) does not affect any rules in Title 26 of the United States Code that otherwise apply to the debt instrument prior to the date of the deemed exchange (for example, this paragraph (d)(1)(i) does not affect the issuer's deduction of accrued but unpaid qualified stated interest otherwise deductible prior to the date of the deemed exchange). Moreover, the stock issued in the deemed exchange is not treated as a payment of accrued but unpaid original issue discount or qualified stated interest on the debt instrument for Federal tax purposes.

(ii) \* \* \* Notwithstanding the first sentence of paragraph (d)(1)(i) of this section, the rules of §1.988-2(b)(13) apply to require the holder and the issuer of a debt

instrument that is deemed to be exchanged under the section 385 regulations, in whole or in part, for stock to recognize any exchange gain or loss, other than any exchange gain or loss with respect to accrued but unpaid qualified stated interest that is not taken into account under paragraph (d)(1)(i) of this section at the time of the deemed exchange. \* \* \*

(iii) Section 108(e)(8). For purposes of section 108(e)(8), if the issuer of a debt instrument is treated as having retired all or a portion of the debt instrument in exchange for stock under paragraph (d)(1)(i) of this section, the stock is treated as having a fair market value equal to the adjusted issue price of that portion of the debt instrument as of the date of the deemed exchange.

(iv) \* \* \*

(A) A debt instrument that is issued by a disregarded entity is deemed to be exchanged for stock of the regarded owner under §1.385-3T(d)(4);

\* \* \* \* \*

## **§1.385-2 [Removed]**

Par. 3. Section 1.385-2 is removed.

Par. 4. Section 1.385-3 is amended by revising paragraph (g)(4) to read as follows:

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

\* \* \* \* \*

(g) \* \* \*

(4) Debt instrument. The term debt instrument means an interest that would, but for the application of this section, be treated as a debt instrument as defined in section 1275(a) and §1.1275-1(d).

\* \* \* \* \*

Par. 5. Section 1.1275-1 is amended by revising the last sentence of paragraph (d) to read as follows:

§1.1275-1 Definitions.

\* \* \* \* \*

(d) \* \* \* See §1.385-3 for rules that treat certain instruments that otherwise would be treated as indebtedness as stock for Federal tax purposes.

\* \* \* \* \*

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: September 30, 2019.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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